Long-duration contracts

Targeted improvements

Handbook



US GAAP

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Targeted – but not simple – improvements

In August 2018, the FASB issued ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, the culmination of a decade-long insurance accounting project. This standard changed how entities recognize, measure, present and disclose long-duration contracts. It was intended to improve, simplify and enhance the financial reporting of long-duration contracts – including providing users with more relevant information and a more current view of expected future cash flows.

Our objective is to help you achieve a thorough understanding of this standard. Although companies have now implemented this standard, accounting and reporting issues and positions continue to evolve. We also aim to help those companies tackle post-implementation challenges.

We hope you will find this Handbook a useful tool when accounting for long-duration contracts.

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About this publication

Accounting literature

The purpose of this Handbook is to assist you in understanding the changes to the accounting for long-duration contracts as a result of the issuance of FASB Accounting Standards Update 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, in August 2018.

Unless otherwise stated, references to the standard and/or ASU 2018-12 include the following Accounting Standards Updates:

- No. 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts
- No. 2019-09, Effective Date
- No. 2020-11, Effective Date and Early Application
- No. 2022-05, Transition for Sold Contracts

Organization of the text

Each chapter of this Handbook includes excerpts from the *FASB Accounting Standards Codification*® and overviews of the relevant requirements.

Our in-depth guidance is explained through Q&As that reflect the questions we are encountering in practice. We include examples to explain key concepts, and we explain the changes from legacy US GAAP.

Our explanations are referenced to the Codification and to other literature, where applicable. The following are examples.

- 944-40-30-19C is paragraph 30-19C of ASC Subtopic 944-40.
- ASU 2018-12.BC67 is paragraph 67 of the basis for conclusions to ASU 2018-12.

November 2026 edition

This edition of our Handbook includes new and updated interpretations based on our experience with companies implementing ASU 2018-12, as well as discussions with the FASB staff.

Compared to the October 2025 edition, new Questions and Examples are identified with ** and items that have been significantly updated or revised are identified with #. The Index of changes identifies all significant changes.

Pending content

The amendments in ASU 2025-11, Interim Reporting (Topic 270): Narrow-Scope Improvements, are labeled as pending content in the Codification excerpts. These amendments are effective for public business entities for interim and annual periods in fiscal years beginning after December 15, 2027 and for all

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other entities for interim and annual periods in fiscal years beginning after December 15, 2028. Early adoption is permitted in any interim reporting period in which financial statements have not yet been issued or made available for issuance.

When an excerpt from the Codification is affected by pending content:

- the specific text that has been added is underlined; and
- the amended text is marked as pending content.

Abbreviations

We use the following abbreviations in this Handbook.

AOCI	Accumulated other comprehensive income
DAC	Deferred acquisition costs
DPL	Deferred profit liability
GLWB	Guaranteed lifetime withdrawal benefits
GMAB	Guaranteed minimum accumulation benefits
GMDB	Guaranteed minimum death benefits
GMIB	Guaranteed minimum income benefits
GMWB	Guaranteed minimum withdrawal benefits
GMXB	Guaranteed minimum benefit features – e.g. GLWB, GMAB, GMDB, GMIB, GMWB
MRB	Market risk benefit
OCI	Other comprehensive income
PAD	Provision for the risk of adverse deviation
PV	Present value (in tables and diagrams)
PVFP	Present value of future profits
SRC	Smaller reporting company
URR	Unearned revenue reserve
VOBA	Value of business acquired

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1. Executive summary

Liability for future policy benefits

ASU 2018-12 changed the accounting for the liability for future policy benefits related to traditional and limited-payment long-duration contracts. The accounting continues to use a net premium model; however, the cash flow assumptions are reviewed annually at the same time every year, or more frequently if suggested by experience. When assumptions are updated, changes are made using a catch-up method.

Calculating the liability

To calculate the liability for future policy benefits for traditional and limited-payment long-duration contracts, an entity first puts contracts into contract groups. Contracts from different issue years cannot be grouped together.

The liability for future policy benefits is calculated as the present value of future benefits to be paid to (or on behalf of) policyholders and certain expenses less the present value of future net premiums receivable. The future benefits include:

- estimated future benefits;
- claim liabilities;
- liabilities for claims in the course of settlement;
- liabilities for incurred but not reported claims; and
- actual benefits paid.

This results in a single liability, so there is no longer a need for separate claims liability calculations.

Discount rate

The discount rate is an upper-medium grade (low-credit-risk) fixed-income instrument yield.

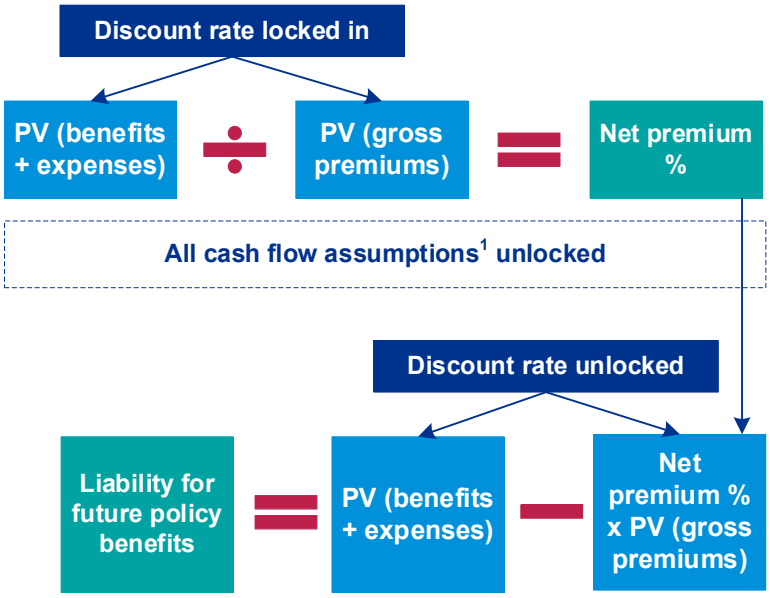
- When measuring the liability for future policy benefits, this discount rate is updated each reporting period with the effect of rate changes recognized through other comprehensive income (OCI).
- When measuring interest accretion, this discount rate is locked in at contract issuance.

ASU 2018-12 did not specify how an entity should determine the upper-medium grade (low-credit-risk) fixed-income instrument yield, other than to maximize observable inputs. Therefore, management will need to apply judgment to determine the discount rate (as well as the expected duration of its liability under the contracts). We believe A-rated public corporate debt securities in the US market reflect an upper-medium grade (low-credit-risk) fixed-income instrument yield.

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Net premium model

The net premium model is used to calculate the liability for future policy benefits.



Note:

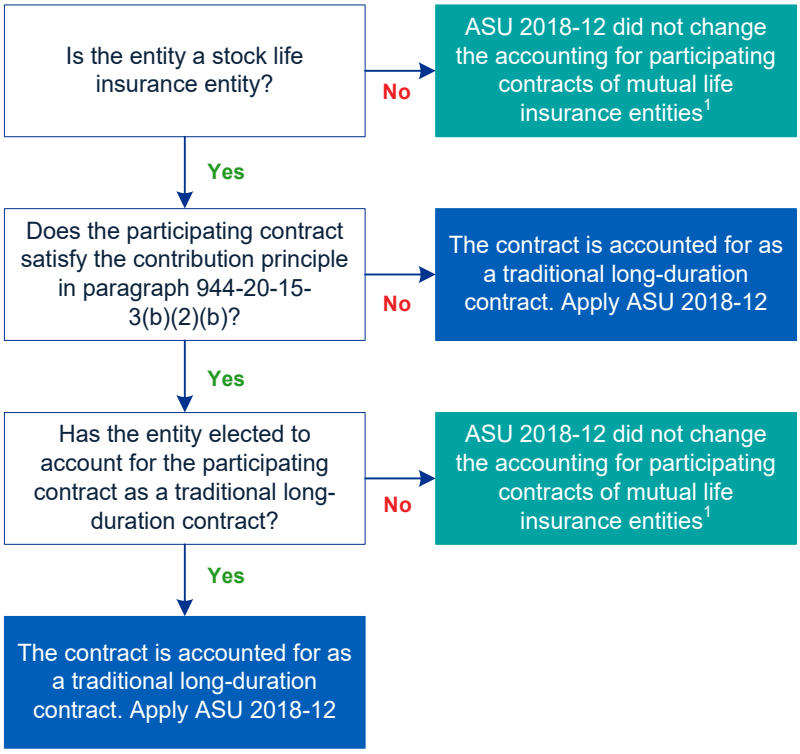
1. Expense assumptions are to be updated consistently with the updated methodology used for other cash flow assumptions unless an entity-wide election is made to not update expense assumptions.

Participating contracts

At contract issuance, an entity can elect to account for certain participating contracts as traditional long-duration contracts, which requires it to calculate the liability for future policy benefits based on the guidance summarized above.

The following steps can help determine whether an entity's accounting for participating contracts changes when adopting ASU 2018-12.

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Note:

1. Except for terminal dividends.

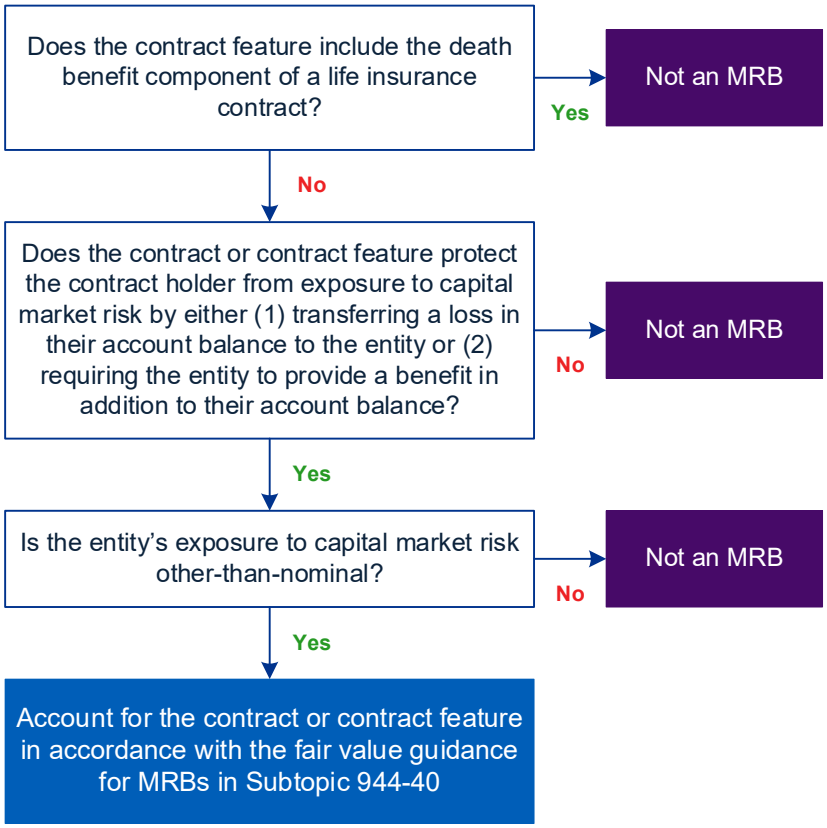
Market risk benefits

Market risk benefits (MRBs) is a term introduced by ASU 2018-12. It defines an MRB as "A contract or contract feature in a long-duration contract issued by an insurance entity that both protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk." The term was created to recognize that certain contracts or contract features provide benefits in addition to the contract holder's account balance.

Identifying MRBs

Identifying MRBs requires judgment; however, the following decision tree is a helpful guide.

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When there are multiple contract features in an individual contract, each feature is separately evaluated to determine if it meets the definition of an MRB.

Measuring MRBs

Prior to the ASU, two measurement models were used to value benefits in addition to the account balance:

- fair value model for an embedded derivative; or
- the insurance benefit model, sometimes referred to as the SOP 03-1 model.

The model used depended on the characteristics of the benefit.

Under the ASU, an entity applies just one measurement model – the fair value model – for all MRBs associated with deposit (or account balance) contracts.

To estimate the fair value of an MRB as a stand-alone feature, it is separated from the underlying insurance contract. We believe an entity uses its judgment to determine the appropriate valuation approach based on the specific facts and circumstances of each MRB. Two methods to measure the fair value of the MRB when separated from the underlying insurance contract are the nonoption valuation approach and the option-based valuation approach. If a contract includes multiple MRBs, those benefits are aggregated and measured as a single compound MRB.

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Presenting MRBs

Changes in the fair value of MRBs are presented separately in the income statement, except for changes attributable to instrument-specific credit risk. The latter type of changes are presented separately in OCI.

Derecognizing MRBs

An MRB is derecognized in the financial statements upon annuitization (for annuitization benefits) or upon extinguishment of the account balance (for withdrawal benefits). The MRB is derecognized at the end of the initial accounting contract. This is also the issue date of a new distinct accounting contract representing the payout phase of the underlying contract.

Reinsurance

An MRB can also exist in a reinsurance arrangement. A reinsurer may assume all or a portion of an MRB. Both the ceding entity and the assuming reinsurer follow the MRB guidance in ASU 2018-12, including the prescribed ordering to determine the appropriate accounting treatment for the contract or contract feature.

Deferred acquisition costs

ASU 2018-12 simplified the amortization method for deferred acquisition costs (DAC) for long-duration contracts. An entity amortizes those costs over the expected term of the related contract(s) on a constant level basis. This amortization method is a departure from the historical amortization method because it is unrelated to revenue or profit emergence.

Capitalization of costs

While ASU 2018-12 did not change the definition of acquisition costs, it did clarify:

- those costs that are not eligible to be capitalized and should be expensed as incurred; and
- that acquisition costs, including future contract costs, are not capitalized or amortized before the costs are actually incurred.

The criteria for capitalizing sales inducements did not change with ASU 2018-12. However, the requirement to evaluate whether the crediting rate (excluding the inducement) is consistent with future profit emergence was removed.

ASU 2018-12 also changed the accounting for maintenance costs. Historically, maintenance costs related to universal-life-type contracts and certain long-duration participating life insurance contracts were expensed as incurred, including those that:

- varied in a constant relationship to premiums or to insurance in force – e.g. premium taxes;

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- were recurring in nature; or
- tended to be incurred in a level amount from period to period – e.g. recurring premium taxes and ultimate level commissions.

The ASU extended this expensing requirement to all long-duration contracts.

Amortization

Under legacy US GAAP, DAC was amortized using amortization models linked to revenue or profit of the related insurance contracts – e.g. premiums, gross profits or gross margins.

In contrast, under ASU 2018-12, capitalized acquisition costs are amortized on a constant level basis over the expected term for either an individual contract or a group of contracts. For an individual contract, amortization expense is recognized on a straight-line basis over the contract's expected term. For grouped contracts, the constant level basis amortization expense should approximate a pattern of straight-line amortization on an individual contract basis.

This change separates the amortization of capitalized acquisition costs from the liability for future policy benefits and from the recognition of the related revenue, gross profit or gross margin.

Additionally, under ASU 2018-12, interest is not accrued on the unamortized DAC balance.

Recoverability

Under ASU 2018-12, DAC is viewed as historical cash flows incurred when the contract was initially issued or renewed. Therefore, DAC is no longer evaluated for recoverability. Instead, the DAC balance is reduced when actual experience is in excess of expected experience – e.g. when contract terminations exceed expectations. Amortization expense recognized in previous closed reporting periods cannot be reversed.

Elimination of shadow DAC

Legacy US GAAP required DAC balances for long-duration contracts to be adjusted for unrealized capital gains and losses because they were amortized using estimated gross profits. The pattern of the cash flows generated by the related contracts (gross profit stream) was adjusted as if the unrealized gains and losses on available-for-sale securities had been realized.

Under ASU 2018-12, this shadow DAC adjustment is eliminated because unrealized investment gains and losses are not considered in DAC amortization.

Reinsurance contracts

The amortization of capitalized acquisition costs for assumed reinsurance contracts follows the simplified guidance in ASU 2018-12. Therefore, capitalized costs are recognized in earnings on a constant level basis using a measure

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other than premiums or profit emergence. However, the ASU did not change the requirement to account for the net cost to the assuming insurance entity as an acquisition cost.

Other accounting items

ASU 2018-12 may have affected other accounting balances, such as the deferred profit liability for limited-payment contracts, unearned revenue reserves, deferred sales inducements and other balances amortized on a basis consistent with DAC.

Deferred profit liability for limited-payment contracts

For limited-payment contracts, a deferred profit liability (DPL) is recorded for gross premium received in excess of the net premium. The DPL is recognized in income in a constant relationship with insurance in force (for life insurance contracts) or with the amount of expected future benefit payments (for annuity contracts). ASU 2018-12 did not change this guidance, except to provide explicit guidance on the costs to be excluded from net premium.

Under ASU 2018-12, the cash flow assumptions used to measure the DPL are consistent with those used to measure the liability for future policy benefits. Therefore, they are reviewed annually at the same time every year, or more frequently if suggested by experience. When cash flow assumptions are updated, changes are made using a catch-up method.

Under ASU 2018-12, the unamortized DPL balance accrues interest. Additionally, the amount of insurance in force or the amount of expected future benefit payments is discounted using the same locked-in upper-medium grade (low-credit-risk) fixed-income instrument yield as the liability for future policy benefits.

The current-period change in the DPL estimate (i.e. liability remeasurement gain (loss)) is presented separately in net income, either parenthetically or in a separate line item.

Other balances amortized on a basis consistent with DAC

Certain balances may be amortized on a basis consistent with DAC because Topic 944 prescribes the amortization method or as a result of an accounting policy election.

Topic 944 prescribes that unearned revenue reserves and deferred sales inducements are amortized on a basis consistent with DAC. Therefore, under ASU 2018-12, these balances are amortized using the simplified DAC amortization method.

ASU 2018-12 does not prescribe a specific amortization method for balances historically amortized on a basis consistent with DAC because of an accounting policy election. These balances may include the present value of future profits, value of business acquired and cost of reinsurance. Under ASU 2018-12, the

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amortization of these balances is either calculated using the legacy US GAAP amortization methodology or changed to the simplified DAC amortization method.

Shadow adjustments

US GAAP requires shadow adjustments be made to the carrying amount of certain financial statement balances to reflect unrealized investment gains or losses as if they had been realized. This adjustment is made when realized investment gains or losses would change the measurement of those balances. When recorded, this shadow adjustment offsets the gross unrealized investment gains or losses in AOCI.

ASU 2018-12 eliminates the consideration of unrealized investment gains and losses in DAC amortization. Because Topic 944 prescribes that unearned revenue reserves and deferred sales inducements are amortized on a basis consistent with DAC, shadow adjustments are not made for these balances.

Under ASU 2018-12, shadow adjustments continue to be made for certain other balances, including:

- the present value of future profits, value of business acquired and cost of reinsurance, if the amortization method considers unrealized investment gains and losses;
- the additional liability for death or other insurance benefit features, including profits followed by losses, if the measurement of the additional liability considers investment performance; and
- any loss recognition, premium deficiency reserves and policyholder dividend obligation reserves for closed block participating contracts, if they meet certain requirements.

Enhanced disclosure requirements

The disclosures in ASU 2018-12 are intended to improve the decision-usefulness of information about long-duration contracts. Disclosures include quantitative information in rollforwards for the liability for future policy benefits, policyholder account balances, MRBs, separate account liabilities and DAC – as well as information about the significant inputs, judgments, assumptions and methods used in measurement.

The new requirements introduce decision points about the level of (dis)aggregation of information to disclose.

The table describes the new disclosures required by ASU 2018-12.

Disclosure	Description
Balance rollforwards for the liability for future policy benefits, policyholder account balances, MRBs, separate account liabilities and DAC	Disaggregated tabular rollforwards reconciled to the balance sheet.

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Disclosure	Description
Measurement assumptions or inputs	Information about significant inputs, judgments, assumptions and methods used in measurement, including the technique(s) used to determine unobservable discount rates.
Other items	Information about gross premiums, gross benefits, actual deviations from expected experience, crediting rates, sales inducements, balances amortized like DAC, and the methodology and results of premium deficiency testing for certain long-duration contracts.

Effective dates and transition

Effective dates	SEC filers, except smaller reporting companies[1,2]	Other entities
Annual periods – Fiscal years beginning after:	Dec. 15, 2022	Dec. 15, 2024
Interim periods – In fiscal years beginning after:	Dec. 15, 2022	Dec. 15, 2025
Transition method		
Liability for future policy benefits[3]	The modified retrospective method (carryover basis transition) is applied to contracts in force at the transition date using updated future cash flow assumptions and eliminates any related amounts in AOCI. The transition date is either the beginning of the prior period presented or the beginning of the earliest period presented. Any transition adjustment is recognized on that date. Retrospective application may be elected, if certain criteria are met. This election requires the use of both actual historical experience information as of contract issuance and the same contract issue-year level on an entity-wide basis for that issue year and all subsequent issue years for all product lines. The availability of historical experience may limit when retrospective adoption can be used.	
Market risk benefits	The retrospective method is applied at the transition date. Determining the assumptions at original contract issuance requires judgment and an evaluation of the availability and relevance of observable data. The use of relevant observable information as of contract issuance is maximized and the use of unobservable information is minimized. If assumptions are unobservable or unavailable and cannot be independently substantiated, hindsight may be used to determine these assumptions.	

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Effective dates	SEC filers, except smaller reporting companies[1,2]	Other entities
Deferred acquisition costs[3]	The modified retrospective method (carryover basis transition) is applied to contracts in force at the transition date. Any transition adjustment is recognized on that date. Retrospective application may be elected, if certain criteria are met. This election requires the use of actual historical experience information as of contract issuance.	
Exclusions		
Contracts derecognized before the effective date because of sale or disposal	At transition, an entity can make an accounting policy election to exclude certain contracts from applying the amendments in ASU 2018-12 when the contracts have been derecognized before the effective date and the entity has no significant continuing involvement. An entity may apply the election on a transaction-by-transaction basis to all contracts in a sale or disposal transaction, if certain criteria are met.	

Notes:

1. An SEC filer is an entity that is required to file or furnish its financial statements with either (1) the SEC or (2) with respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section. Financial statements for other entities that are not otherwise SEC filers whose financial statements are included with another filer's SEC submission are not included in this definition.
2. A company's determination about whether it is eligible to be a 'smaller reporting company' is based on its most recent filing determination in accordance with SEC regulations as of November 15, 2019.
3. The transition method, issue year level, and transition date used for the liability for future policy benefits and DAC should be the same.

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2. Liability for future policy benefits

Detailed contents

New item added in this edition: **
Item significantly updated in this edition: #

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Question 2.2.45 Can an entity group contracts with different accounting models or functional currencies?

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Example 2.2.20 Remeasurement of liability for future policy benefits – no capping of the net premium ratio#

Example 2.2.30 Remeasurement of liability for future policy benefits – net premium ratio capped at 100%**

Example 2.2.40 Remeasurement of liability for future policy benefits – net premium ratio reduced below 100%**

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2.3.10 Reviewing and updating cash flow assumptions

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Question 2.3.100 [Not used]

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Question 2.5.30 Does ASU 2018-12 change the guidance for contract grouping for premium deficiency testing?

[1] Questions 2.5.170 to 2.5.190 and 2.5.250 to 2.5.290 are not used.

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Question 2.5.40 How does an entity calculate the additional liability for annuitization benefits?

Question 2.5.50 When does an entity recognize an additional liability for annuitization benefits?

Question 2.5.60 Does ASU 2018-12 change the benefit ratio formula used to calculate the additional liability for annuitization benefits?

Question 2.5.70 Does ASU 2018-12 change the discount rate used to calculate the present value of annuity payments?

Question 2.5.80 What is the contract rate?

Question 2.5.90 Does an entity recognize changes in the discount rate for the benefit ratio in OCI?

Question 2.5.100 How does an entity calculate the additional liability for death or other insurance benefits?

Question 2.5.110 When does an entity recognize an additional liability for death or other insurance benefits?

Question 2.5.120 Does ASU 2018-12 change the benefit ratio formula used to calculate the additional liability for death or other insurance benefits?

Question 2.5.130 Does ASU 2018-12 change the discount rate an entity uses to calculate the present value of excess payments and assessments?

Question 2.5.140 Does an entity include investment margin in expected assessments in the benefit ratio?

Question 2.5.150 Do assessments include amortization of unearned revenue reserves?

Question 2.5.160 How are claims liabilities measured?

Question 2.5.200 How is the reinsurance recoverable recognized?

Question 2.5.210 How is the interest accretion rate used to estimate the reinsurance recoverable determined?

Question 2.5.220 How is the reinsurance recoverable affected by the requirement that the revised net premium ratio for direct insurance contracts not exceed 100%?

Question 2.5.230 How is the reinsurance recoverable affected by the requirement that the liability is floored at zero for direct insurance contracts?

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Question 2.5.240 Do the cash flows used to measure the liability for future policy benefits change when contracts are ceded?

Question 2.5.300 Are assumed traditional and limited-payment long-duration reinsurance contracts subject to the guidance for direct insurance contracts?

Question 2.5.310 What is the unit of account for assumed traditional and limited-payment long-duration reinsurance contracts?

2.6 Participating contracts

Questions

Question 2.6.10 Can an entity change its accounting policy election for participating contracts?

Question 2.6.20 How are terminal dividends accrued?

2.7 Presentation

Questions

Question 2.7.10 Can an entity combine the remeasurement gain (loss) with other items?#

Question 2.7.20 Can an entity present the liability for future policy benefits in two financial statement captions?

2.8 Transition

2.9 Liability for future policy benefits examples

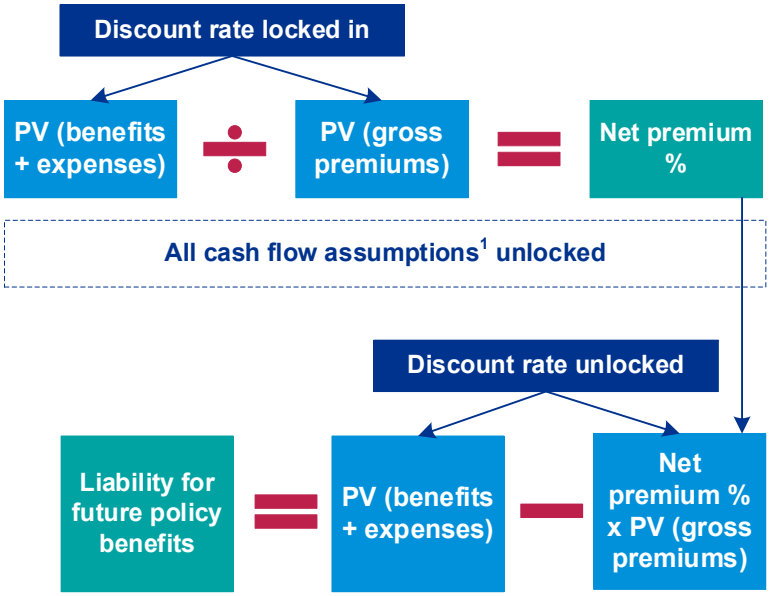
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2.1 How the standard works

ASU 2018-12 changed the accounting for the liability for future policy benefits related to traditional and limited-payment long-duration contracts. An entity reviews cash flow assumptions at the same time every year, and updates the assumptions if there is a change, unless experience suggests more frequent updates. The discount rate assumption is also specified as an upper-medium grade (low-credit-risk) fixed-income instrument yield, which is updated each reporting period to measure the liability for future policy benefits.

An entity calculates the liability for future policy benefits for traditional and limited-payment long-duration contracts as the present value of future benefits to be paid to or on behalf of policyholders and certain expenses less the present value of future net premiums receivable under the contracts.

The net premium model is used to calculate the liability for future policy benefits.



Note:

1. Expense assumptions are to be updated consistently with the updated methodology used for other cash flow assumptions unless an entity-wide election is made to not update expense assumptions.

An entity cannot group contracts from different issue years but can group them into smaller groups – e.g. quarterly, monthly or daily. The calculated liability for future policy benefits cannot be less than zero for the level of aggregation used to calculate the liability. Cash flow assumptions do not include a PAD.

ASU 2018-12 does not change the accounting for the liability for participating contracts of mutual life insurance entities or contracts that meet the criteria in paragraph 944-20-15-3(b), except for terminal dividends. For guidance on participating contracts, see section 2.6.

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Comparison to legacy US GAAP Legacy US GAAP vs ASU 2018-12

The following table summarizes the key changes from legacy US GAAP for traditional and limited-payment long-duration contracts.

Legacy US GAAP	ASU 2018-12
Cash flow assumptions, including a PAD, were locked in at contract issuance and not updated unless a premium deficiency existed.	• Cash flow assumptions are reviewed annually at the same time every year, or more frequently if suggested by experience. If cash flow assumptions are changed, updates are made using a catch-up method for the net premium ratio. Changes are recognized as a component within benefit expense – as a separate line item or parenthetically in the income statement. • Assumptions do not include a PAD.
Premium deficiency analysis was required.	Premium deficiency analysis is no longer required, however the net premium ratio cannot exceed 100%.[1]
Cash flows were discounted using a locked-in expected net investment yield.	Discount the cash flows used to measure the liability for future policy benefits using a current upper-medium grade (low-credit-risk) fixed-income instrument yield (updated each reporting period) with the effect of rate changes recognized in OCI.
Interest accretion used a locked-in expected net investment yield.	Accrete interest using upper-medium grade (low-credit-risk) fixed-income instrument yield locked in at contract issuance.

Note:

1. When the net premium ratio exceeds 100%, net premiums are set equal to gross premiums and the liability for future policy benefits is increased with a corresponding charge to net income in the current period.

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2.2 Net premium model

Excerpt from ASC 944-40

Long-Duration Contracts

> Overall

25-8 The present value of estimated future policy benefits to be paid to or on behalf of policyholders less the present value of estimated future **net premiums** to be collected from policyholders—that is, a **liability for future policy benefits**—shall be accrued when premium revenue is recognized.

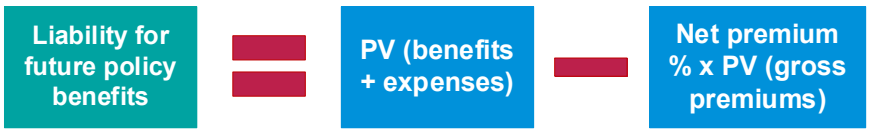
25-9 In addition, as discussed in paragraph 944-40-25-1 liabilities for unpaid claims and **claim adjustment expenses** shall be accrued when insured events occur.

> Traditional and Limited-Payment Long-Duration Contracts

25-11 The liability for future policy benefits represents the present value of future benefits to be paid to or on behalf of policyholders and certain related expenses less the present value of future net premiums receivable under the insurance contracts. In no event shall net premiums exceed gross premiums.

Question 2.2.10 Does ASU 2018-12 change the net premium model?

Interpretive response: No. The fundamental net premium model remains the same. The liability for future policy benefits is calculated as follows. [944-40-25-11]



ASU 2018-12 caps the net premium ratio at 100% and the liability for future policy benefits can never be less than zero. For additional guidance, see section 2.3.60. [944-40-30-7A]

For guidance on grouping contracts to calculate the liability for future policy benefits, see section 2.2.10.

For guidance on cash flow assumptions and the discount rate used in the net premium model, see sections 2.3 and 2.4, respectively.

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2.2.10 Grouping contracts to calculate the liability for future policy benefits

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

30-7 … In determining the level of aggregation at which reserves are calculated, an insurance entity shall not group contracts together from different issue years but shall group contracts into quarterly or annual groups.

Under legacy US GAAP, an entity calculated the liability for future policy benefits on an individual contract (seriatim) basis or by contract groups. An entity uses contract groups to calculate the liability under ASU 2018-12. Contracts from different issue years cannot be grouped. ASU 2018-12 does not provide additional guidance on how to group contracts to calculate the liability. [944-40-30-7]

Question 2.2.20 Can an entity group contracts at a lower level than issue year?

Interpretive response: Yes. An entity has a choice of the period for which it groups contracts. However, the contract group can be no greater than an annual period. For example, an entity may group contracts on an annual, quarterly, monthly, weekly or daily basis depending on the specific facts and circumstances. [944-40-30-7, ASU 2018-12.BC48]

Question 2.2.30 Can an entity calculate the liability for future policy benefits on a seriatim basis?

Interpretive response: No. ASU 2018-12 requires the catch-up method to reflect remeasurement of the liability for future policy benefits. Because this method requires using historical information for contracts terminated and in force, an entity that previously calculated the liability on a seriatim basis will need to include contracts in a contract group to perform the catch-up calculation. [944-40-30-7]

Question 2.2.40 Can an entity group different product lines to calculate the liability for future policy benefits?

Interpretive response: It depends. ASU 2018-12 is silent on grouping contracts from different product lines. The level of aggregation used to calculate the liability for future policy benefits requires judgment.

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It may be appropriate to group contracts at the product line level, or a level below. However, we believe an entity should not group contracts at a level higher than the product line. For example, an entity should not group whole life contracts with term life contracts. This view is consistent with the example disclosure separating term life and whole life in paragraph 944-40-55-29E. However, we believe an entity may be able to group term life contracts with different term periods. [944-40-30-7]

Observation Grouping contracts

Determining the appropriate contract grouping to estimate the liability for future policy benefits is an important first step in the adoption of ASU 2018-12. Grouping contracts to calculate the liability requires judgment. Considerations for grouping include a contract's:

- issue date;
- product line;
- pricing, including expected profitability;
- expected term or duration; and
- benefit features.

An entity may also find it helpful to consider the Subtopic 944-40 disclosure aggregation requirements when determining the appropriate contract groups for measurement.

Question 2.2.45 Can an entity group contracts with different accounting models or functional currencies?

Interpretive response: No. Because all contracts within a contract group are accounted for consistently, we do not believe an entity should group contracts that have a different:

- accounting method – e.g. traditional versus limited-payment contracts; or
- functional currency.

Excerpt from ASC 944-805

General

> Insurance and Reinsurance Contracts Acquired

25-1 The acquirer shall consider insurance and **reinsurance** contracts acquired in a business combination to be new contracts for measurement and accounting purposes.

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Question 2.2.50 How does an entity group contracts acquired in a business combination?

Interpretive response: Contracts acquired in a business combination will have the same issue year based on the acquisition date. [944-805-25-1]

This may result in contracts from different original issue years being included in the same contract group. An entity also considers product lines when grouping acquired contracts (see Question 2.2.40). This may result in grouping contracts acquired in a single business combination in different contract groups with the same issue year.

Question 2.2.60 Can an entity change its contract grouping for an established contract group?

Interpretive response: No. To establish its contract grouping, an entity determines the contracts that will be aggregated to calculate the liability for future policy benefits at initial measurement. Topic 944 does not provide guidance on contract groupings after initial measurement. Therefore, we believe the contract grouping determination is an irrevocable decision made at initial measurement and is not an accounting policy choice, a cash flow assumption or a discount rate assumption. As such, we do not believe an entity can change the contract grouping once established. [944-40-30-7]

However, we believe that an entity makes a new contract grouping determination at initial measurement as new business is written. Therefore, it may group contracts for new (future) contract groupings differently from how they were grouped for established (historical) contract groupings. This can result in an entity having different contract groupings for different issue periods.

For further discussion about level of aggregation considerations, see Question 2.2.40 and Observation – Grouping contracts.

Question 2.2.70 Do an entity's annual contract groups have to align with the calendar year?

Interpretive response: No. An entity has a choice as to which 12-month period it considers an issue year when aggregating contracts into annual contract groups. Contracts from different issue years cannot be aggregated. However, ASU 2018-12 does not define an issue year.

For example, when selecting an annual grouping, an entity may decide to group contracts from July 1 – June 30 because it aligns with the timing of its reinsurance contracts or its internal processes – e.g. pricing or annual assumption updates. [944-40-30-7]

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Example 2.2.10 Term insurance – contract grouping determination

Life Insurer sells both 10- and 30-year term life insurance. Life Insurer has concluded that it will use issue year (annual) contract groups to calculate the liability for future policy benefits. Life Insurer is evaluating its term life insurance groupings to determine whether to aggregate the 10- and 30-year term life insurance contracts into a single contract group under ASU 2018-12.

The 10- and 30-year term life products used in this example share the same characteristics and assumptions – i.e. issue year, issue age, gender, face amount, mortality assumptions, and discount rates – with the only difference being the term period.

To illustrate how profitability interacts with the (dis)aggregation for contract groupings, the profit-loading component of premiums for the 30-year term life product is different in each of the scenarios below to target different net premium ratios, while other actuarial assumptions have been held constant – i.e. expected benefits are identical under both scenarios.

For each scenario, Life Insurer calculates the expected income statement and balance sheet impact of (dis)aggregating the 10- and 30-year term products for contract group determination. For illustrative purposes, those amounts are referred to as:

- 'summed' results from disaggregating the 10- and 30-year term products into separate contract groupings – i.e. the financial statement result of the sum of the two individual contract groups that are calculated with distinct and separate net premium ratios.
- 'combined' results from aggregating the 10- and 30-year term products into the same single contract grouping – i.e. the financial statement result of the combined single contract group that is calculated using a single net premium ratio.

This results in the 'summed' liability and the 'combined' liability being different when the 10- and 30-year term products have different net premium ratios.

Scenario 1: Same net premium ratios

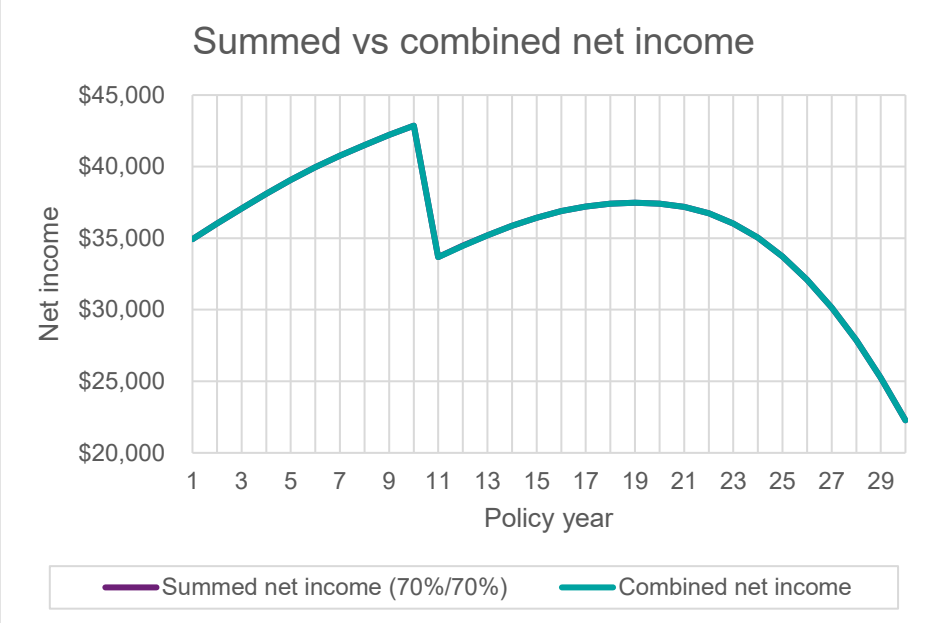
Life Insurer calculated the net premium ratio (NPR) for each term life insurance product and concluded that the net premium ratio is 70% for both the 10- and 30-year term products. For a single issue year, Life Insurer uses this information to derive the expected financial statement impact for each year within the full duration (30 years) on both a summed and combined basis, as illustrated below.

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Net income				
Policy year-end	Term 10 (70% NPR) (A)	Term 30 (70% NPR) (B)	Summed (70% NPR) (two individual contract groups) (A + B)	Combined (70% NPR) (single contract group)
Year 1	10,030	24,901	34,931	34,931
Year 2	10,191	25,831	36,022	36,022
[…]	[…]	[…]	[…]	[…]

Liability for future policy benefits				
Policy year-end	Term 10 (70% NPR) (A)	Term 30 (70% NPR) (B)	Summed (70% NPR) (two individual contract groups) (A + B)	Combined (70% NPR) (single contract group)
Year 1	8,945	48,739	57,684	57,684
Year 2	16,535	97,643	114,178	114,178
[…]	[…]	[…]	[…]	[…]

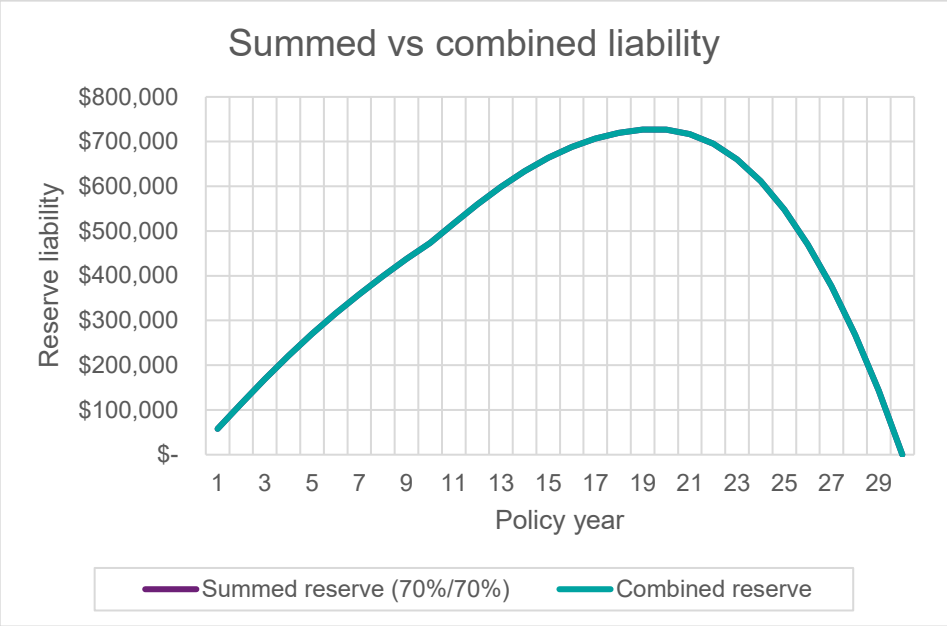
Life Insurer uses this information to determine its contract groups for this issue year. When the net premium ratio is the same for the 10- and 30-year term products, there is negligible income statement difference when aggregated into a single contract group (combined) or disaggregated into separate contract groups (summed). Therefore, the two lines in the illustration below appear as one single line.



Additionally, when the net premium ratio is the same for the 10- and 30-year term products, there is negligible difference in the liability for future policy

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benefits when aggregated into a single contract group (combined) versus disaggregated into separate contract groups (summed). Therefore, the two lines in the illustration below appear as one single line.



Because the expected financial results from 10- and 30-year term products are similar, Life Insurer decides to aggregate them into a single contract group when measuring the liability for future policy benefits.

Scenario 2: Different net premium ratios

Life Insurer calculated the net premium ratio for its term life insurance products and concluded that the net premium ratio is 70% for the 10-year term product and 50% for the 30-year term product. For a single issue year, Life Insurer uses this information to derive the expected financial statement impact for each year within the full duration (30 years) on both a summed and combined basis, as illustrated below.

Net income				
Policy year-end	**Term 10 (70% NPR) (A)**	**Term 30 (50% NPR) (B)**	**Summed (50%/70% NPR) (two individual contract groups) (A + B)**	**Combined (53% NPR) (single contract group)**
Year 1	10,030	61,511	71,541	74,974
Year 2	10,191	62,376	72,567	75,924
[…]	[…]	[…]	[…]	[…]

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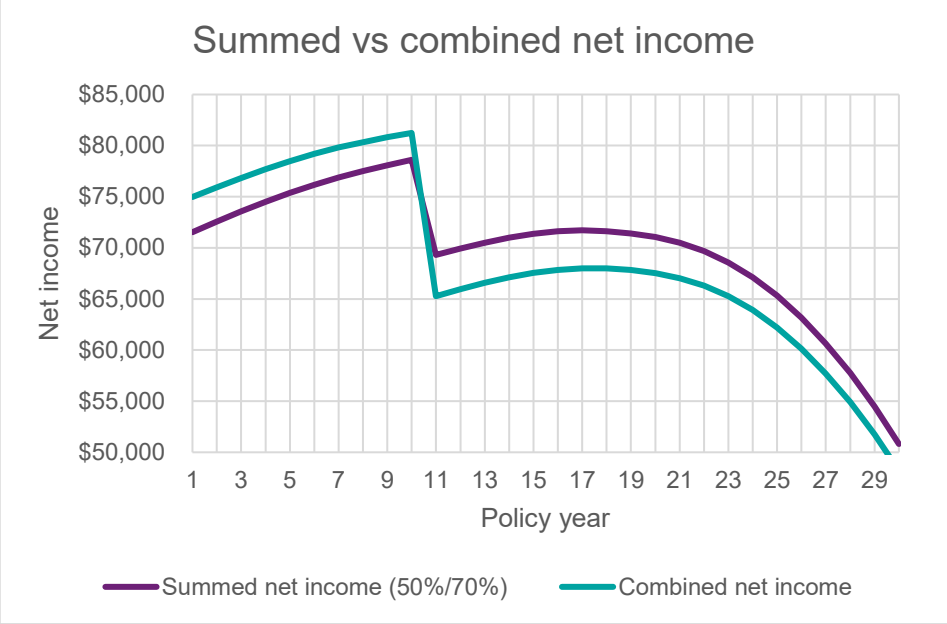
Liability for future policy benefits				
Policy year-end	**Term 10 (70% NPR) (A)**	**Term 30 (50% NPR) (B)**	**Summed (50%/70% NPR) (two individual contract groups) (A + B)**	**Combined (53% NPR) (single contract group)**
Year 1	8,945	48,739	57,684	54,251
Year 2	16,535	97,643	114,178	107,182
[…]	[…]	[…]	[…]	[…]

Life Insurer uses this information to determine its contract groups for this issue year. In this scenario where the net premium ratio is higher for the 10-year term product than for the 30-year term product, the combined net premium ratio for the single combined contract group is biased toward the longer duration product. The resulting net premium ratio is 53%.

As a result, for Policy Years:

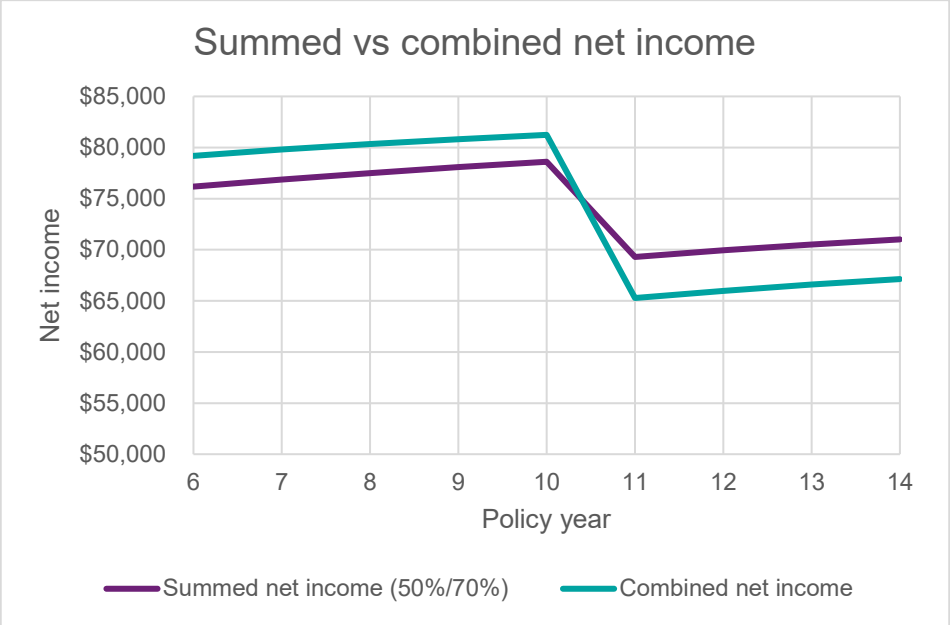
- 0 to 10, the combined net premium (single contract group) is lower than the summed approach (separate contract groups); and
- 11 to 30, the combined net premium (single contract group) is higher than the summed approach (separate contract group).

Aggregating the two products into a single contract group (combined) accelerates income during the period when the 10-year term product is in force and results in the inverse after the 10-year term product is no longer in force, as illustrated below.

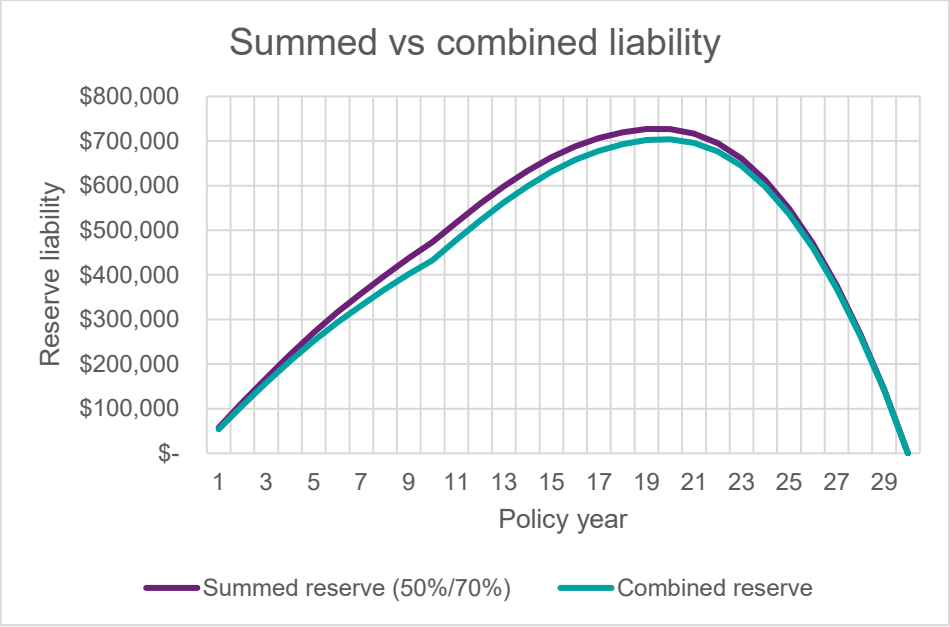


For illustrative purposes, Policy Years 6 to 14 are isolated and highlighted in more detail below.

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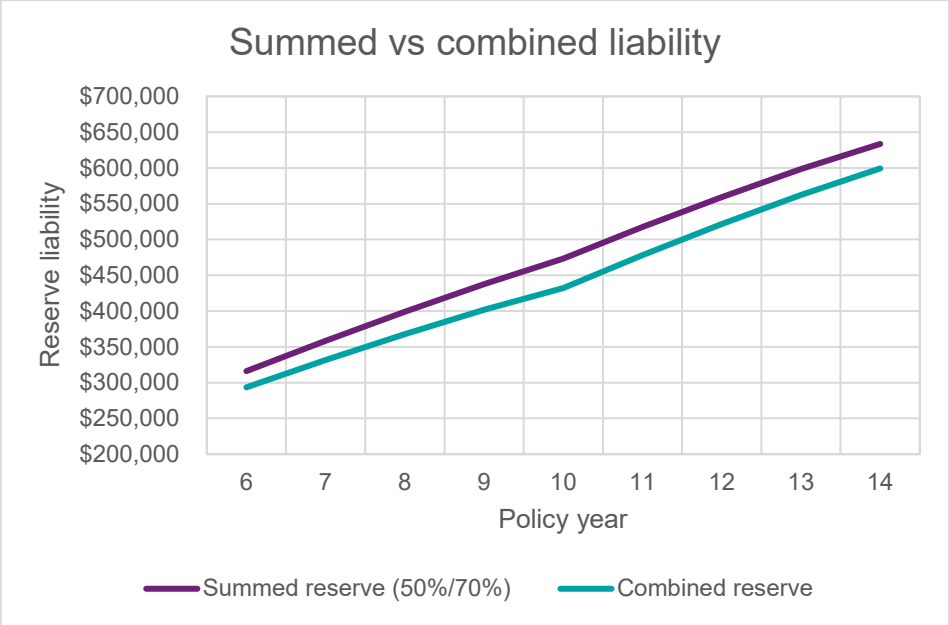


Additionally, in this scenario, there are lower upfront net premiums under the combined (single contract group) approach. However, after the 10-year term product is no longer in force, the combined approach has higher net premiums than the summed (separate contract groups) approach. This results in a pattern whereby the combined reserve is always lower than the summed reserve, as illustrated below.



For illustrative purposes, Policy Years 6 to 14 are isolated and highlighted in more detail below.

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Because the expected financial results from the 10- and 30-year term products are dissimilar, Life Insurer concludes that disaggregation into separate contract groups allows it to better explain its financial results to key stakeholders.

Example 2.2.20 Remeasurement of liability for future policy benefits – no capping of the net premium ratio#

Life Insurer writes 10-year term life insurance.

Under legacy US GAAP, Life Insurer calculated the locked-in net premium ratio at contract issuance that was used to calculate the liability for future policy benefits at each subsequent reporting period. The legacy discount rate of 5% is the locked-in discount rate at transition.

See Question 2.3.200 for guidance on determining the 'carrying value of liability prior to transition' used to calculate the net premium ratio after transition when a loss is recorded at transition because the net premium ratio was greater than 100%.

Life Insurer adopts ASU 2018-12 at the transition date (beginning of Policy Year 6) using the modified retrospective transition method. For illustrative purposes this example assumes no lapses, no claim settlement expenses, no reserve transition adjustments, and the isolation of historical actual and projected future cash flow updates to claims. Example 7.3.30 illustrates the adoption using the modified retrospective transition method using this same fact pattern.

The numbers in this example are rounded.

At transition (beginning of Policy Year 6)

As illustrated in Example 7.3.30, at transition, Life Insurer updates its expectations of future cash flows for the remaining policy years to reflect

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management's best estimates as follows. Life Insurer calculates the present value of projected future cash flows using the locked-in discount rate of 5% to determine the net premium ratio at transition of 67.74%.

Projected future cash flows		
Policy year	**Projected premiums**	**Projected claims**
6	100,000	70,000
7	100,000	75,000
8	100,000	85,000
9	100,000	85,000
10	100,000	100,000

The following information is relevant at transition.

Relevant financial statement information at transition	
Liability at transition (using the current ASU 2018-12 discount rate of 4%)	65,498
Liability before transition (using locked-in discount rate of 5%)	63,126
AOCI balance at transition (debit balance) ($65,498 – $63,126) (*difference in liability calculated using current discount rate and locked-in discount rate)*	2,372

End of Policy Year 6

Update cash flows

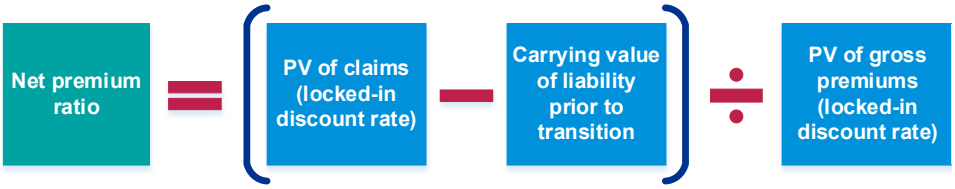
During Policy Year 6 (one year after transition), Life Insurer has $75,000 of actual Year 6 claim experience. The higher-than-expected claim experience results in a reduction to the inforce and lower future projected claims. Life Insurer's analysis at the end of Policy Year 6 supports its current assumptions and as a result, Life Insurer does not revise its best estimates of the future underlying cash flow assumptions.

At the end of Policy Year 6, Life Insurer updates its projected future cash flows for actual experience as follows. Life Insurer calculates the present value of the updated projected future cash flows as of the beginning of Policy Year 6 using the locked-in discount rate (5%) to recalculate the net premium ratio as of that date as follows.

Present value of historical actuals and projected future cash flows	
Cash flows	**At locked-in discount rate (5%)**
Projected gross premium cash flows (actual gross premiums for Year 6 and projected gross premiums for Years 7 to 10)	432,948
Projected claim cash flows (actual claims for Year 6 and projected claims for Years 7 to 10)	361,164

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Life Insurer uses the calculated present value of those projected future cash flows to recalculate the net premium ratio as of the beginning of Policy Year 6 (the transition date) of 68.84% [($361,164 – $63,126) ÷ $432,948] as follows.



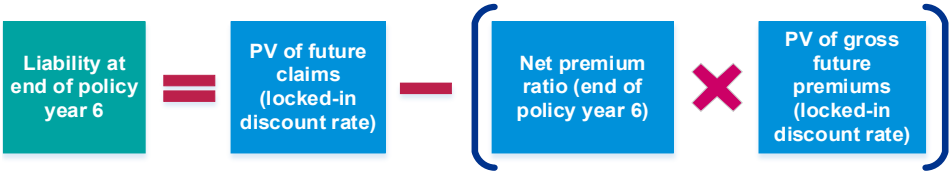
Determine liability

Life Insurer calculates the present value of the updated projected future cash flows at the end of Policy Year 6 using both the locked-in discount rate (5%) and current discount rate at the end of Policy Year 6 (3.75%) to calculate the liability for future policy benefits at the end of Policy Year 6 as follows.

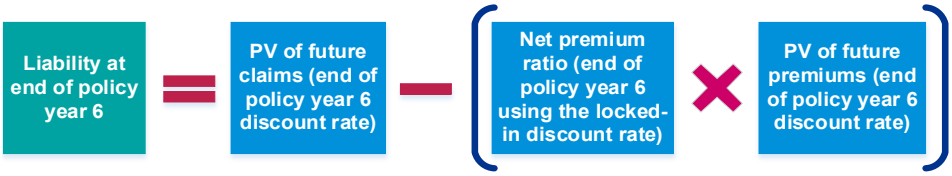
Present value of projected future cash flows		
Cash flows	**At locked-in discount rate (5%)**	**At current Policy Year 6 discount rate (3.75%)**
Projected gross premium cash flows (projected gross premiums for Years 7 to 10)	354,595	365,138
Projected claim cash flows (projected claims for Years 7 to 10)	304,223	313,675

Life Insurer then uses the end of Policy Year 6 recalculated net premium ratio as of the beginning of Policy Year 6 and the present value of projected future cash flows at the end of Policy Year 6 to calculate the liability for future policy benefits at the end of Policy Year 6.

Using the locked-in discount rate of 5%, the liability for future policy benefits at the end of Policy Year 6 is $60,120 [$304,223 – (68.84% × $354,595)], calculated as follows.



Using the current discount rate of 3.75% at the end of Policy Year 6, the liability for future policy benefits is $62,314 [$313,675 – (68.84% × $365,138)], calculated as follows.



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Life Insurer calculates the change in the liability for future policy benefits for the current period at the locked-in discount rate to determine the amount of the change recorded in the income statement.

Change in liability (Policy Year 6) at locked-in discount rate	
Liability at end of Policy Year 6 (using locked-in discount rate of 5%)	60,120
Less: Liability at end of prior year (using locked-in discount rate of 5%)	63,126
Change in liability balance for the period ($60,120 – $63,126)	(3,006)

Calculate OCI change

Life Insurer calculates the AOCI balance at the end of Policy Year 6 and records the change for the year as follows. The AOCI balance is the change in discount rates from the locked-in discount rate to the current discount rate.

Change in AOCI at the end of Policy Year 6	
Liability at end of Policy Year 6 (using current discount rate of 3.75%)	62,314
Less: Liability at end of Policy Year 6 (using locked-in discount rate of 5%)	60,120
AOCI balance at end of Policy Year 6 (debit balance) ($62,314 – $60,120)	2,194
AOCI balance recorded at transition (end of prior period) (debit balance)	2,372
Change in AOCI for Policy Year 6 ($2,194 – $2,372)	(178)

Life Insurer records the following journal entry.

	Debit	Credit
Liability for future policy benefits and claims	3,184	
OCI		178
Policyholder benefits and claims		3,006
To record entry to update liability for future policy benefits at end of Year 6 (one year after adoption).		

Remeasuring the liability for future policy benefits does not result in Life Insurer recording a remeasurement gain (loss) for the current period. This is because the date that Life Insurer uses to recalculate the net premium ratio for the current period is the transition date – i.e. the beginning of Policy Year 6 – and the remeasured net premium ratio was not capped at 100%.

At the transition date, Life Insurer measured the liability for future policy benefits using the carryover basis of the liability prior to transition, adjusted to reflect the difference in discount rates through AOCI, with any differences to the net premium ratio from updated assumptions prospectively recognized in future periods.

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In this example, remeasuring the net premium ratio for actual Policy Year 6 claim experience results in the change in the present value of expected net premiums equaling the change in the present value of expected future policy benefits at the beginning of the current period. This is because the remeasured net premium ratio was not capped at 100%. The result is no remeasurement gain (loss) recorded in the income statement for the current period.

However, Life Insurer separately discloses the effect of remeasuring the net premium ratio on the present value of expected net premiums and the present value of expected future policy benefits in the respective sections of the tabular rollforward disclosure of the liability for future policy benefits.

For additional discussion about remeasurement gain (loss), see section 2.3. For additional discussion about disclosures, see chapter 6.

Example 2.2.30 Remeasurement of liability for future policy benefits – net premium ratio capped at 100%**

Life Insurer writes 10-year term life insurance.

Under legacy US GAAP, Life Insurer calculated the locked-in net premium ratio at contract issuance that was used to calculate the liability for future policy benefits at each subsequent reporting period. The legacy discount rate of 5% is the locked-in discount rate at transition. The carrying value of the liability at transition is $60,855.

See Question 2.3.200 for guidance on determining the 'carrying value of liability prior to transition' used to calculate the net premium ratio after transition when a loss is recorded at transition because the net premium ratio was greater than 100%.

Life Insurer adopts ASU 2018-12 at the transition date (beginning of Policy Year 6) using the modified retrospective transition method. Life Insurer calculates the present value of projected future cash flows using the locked-in discount rate of 5% to determine the net premium ratio at transition of 96.91%. For illustrative purposes this example assumes no lapses, no claim settlement expenses, no reserve transition adjustments, and the isolation of historical actual and projected future cash flow updates to claims.

The numbers in this example are rounded.

End of Policy Year 6

Update cash flows

During Policy Year 6 (one year after transition), Life Insurer has $112,500 of actual Year 6 claim experience. The higher-than-expected claim experience results in a reduction to the inforce and lower future projected claims. Life Insurer's analysis at the end of Policy Year 6 supports its current assumptions and as a result, Life Insurer does not revise its best estimates of the future underlying cash flow assumptions. At the end of Policy Year 6, Life Insurer updates its projected future cash flows for actual experience as follows.

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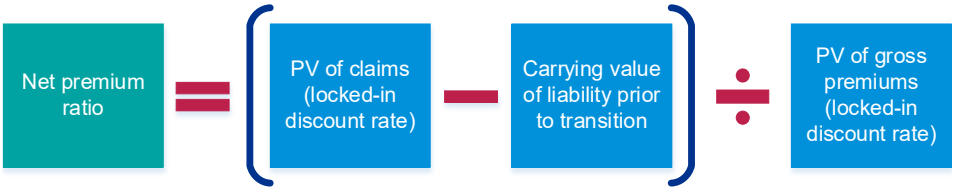
Projected future cash flows				
Policy year	Projected premiums – at transition	Projected claims – at transition	Actual and projected premiums – updated	Actual and projected claims – updated
6	87,500	93,500	87,500	112,500
7	85,000	96,000	85,000	95,000
8	82,500	98,500	82,500	97,500
9	80,000	101,000	80,000	100,000
10	77,500	103,500	77,500	102,500

Recalculate net premium ratio

Life Insurer calculates the present value of the updated projected future cash flows as of the beginning of Policy Year 6 using the locked-in discount rate (5%) to recalculate the net premium ratio as of that date as follows.

Present value of historical actuals and projected future cash flows	
Cash flows	At locked-in discount rate (5%)
Projected gross premium cash flows (actual gross premiums for Year 6 and projected gross premiums for Years 7 to 10)	376,149
Projected claim cash flows (actual claims for Year 6 and projected claims for Years 7 to 10)	440,117

Life Insurer uses the calculated present value of those projected future cash flows to recalculate the net premium ratio as of the beginning of Policy Year 6 (the transition date) of 100.83% [($440,117 – $60,855) ÷ $376,149] as follows.



Under ASU 2018-12, the net premium ratio cannot exceed 100%. Based on updated Policy Year 6 actual claim experience, the recalculated net premium ratio would be 100.83%. Therefore, Life Insurer caps the ratio at 100%.

Determine liability

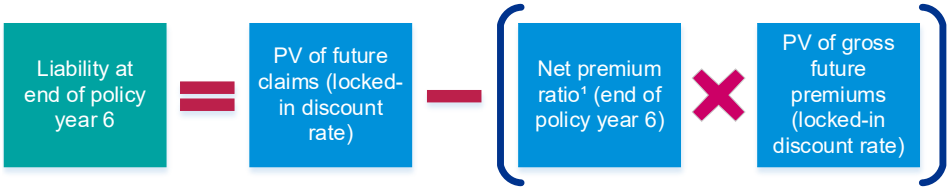
Life Insurer calculates the present value of the updated projected future cash flows at the end of Policy Year 6 using both the locked-in discount rate (5%) and current discount rate at the end of Policy Year 6 (4%) to calculate the liability for future policy benefits at the end of Policy Year 6 as follows.

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Present value of projected future cash flows		
Cash flows	**At locked-in discount rate (5%)**	**At current Policy Year 6 discount rate (4%)**
Projected gross premium cash flows (projected gross premiums for Years 7 to 10)	303,081	307,188
Projected claim cash flows (projected claims for Years 7 to 10)	349,622	358,007

Life Insurer then uses the end of Policy Year 6 recalculated net premium ratio (capped at 100%) as of the beginning of Policy Year 6 and the present value of projected future cash flows at the end of Policy Year 6 to calculate the liability for future policy benefits at the end of Policy Year 6.

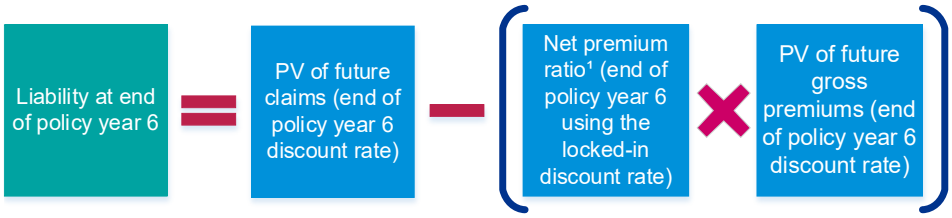
Using the locked-in discount rate of 5%, the liability for future policy benefits at the end of Policy Year 6 is $46,541 [$349,622 – (100% × $303,081)], calculated as follows.



Note:

1. Ratio of net premiums to gross premiums is equal to 100%.

Using the current discount rate of 4% at the end of Policy Year 6, the liability for future policy benefits is $50,819 [$358,007 – (100% × $307,188)], calculated as follows.



Note:

1. Ratio of net premiums to gross premiums is equal to 100%.

Life Insurer calculates the change in the liability for future policy benefits for the current period at the locked-in discount rate to determine the amount of the change recorded in the income statement.

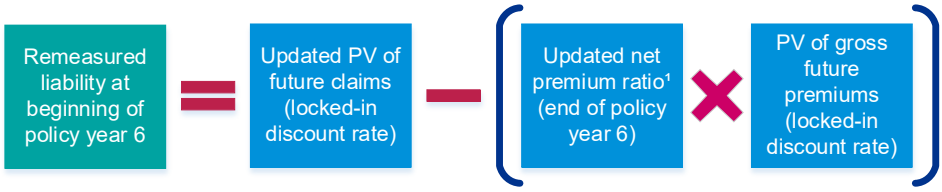
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Change in liability (Policy Year 6) at locked-in discount rate	
Liability at end of Policy Year 6 (using locked-in discount rate of 5%)	46,541
Less: Liability at end of prior year (using locked-in discount rate of 5%)	60,855
Change in liability balance for the period ($46,541 – $60,855)	(14,314)

Calculate remeasurement loss

The remeasurement loss is the change in the liability as of the beginning of Policy Year 6 resulting from unfavorable Year 6 actual claim experience and the requirement to cap the net premium ratio at 100%. This loss is recognized immediately in earnings using the catch-up method.

Life Insurer calculates the remeasured liability for future policy benefits as of the beginning of Policy Year 6 of $63,968 [$440,117 – (100% × $376,149)] using the locked-in discount rate of 5% as follows.



Note:

1. Ratio of net premiums to gross premiums is equal to 100%.

Life Insurer calculates the remeasurement loss of $3,113 ($63,968 – $60,855) as follows.



Life Insurer records the following journal entry to recognize the remeasurement loss.

	Debit	Credit
Remeasurement loss	3,113	
Liability for future policy benefits and claims		3,113
To record entry for the remeasurement loss to recognize changes in the net premium ratio for unfavorable Year 6 actual claim experience and capping (i.e. catch-up method).		

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Determine current-period activity – Premiums and claims

Life Insurer records the following journal entries for Policy Year 6 gross premiums collected (premium revenue) and cash disbursement for benefits and claims.

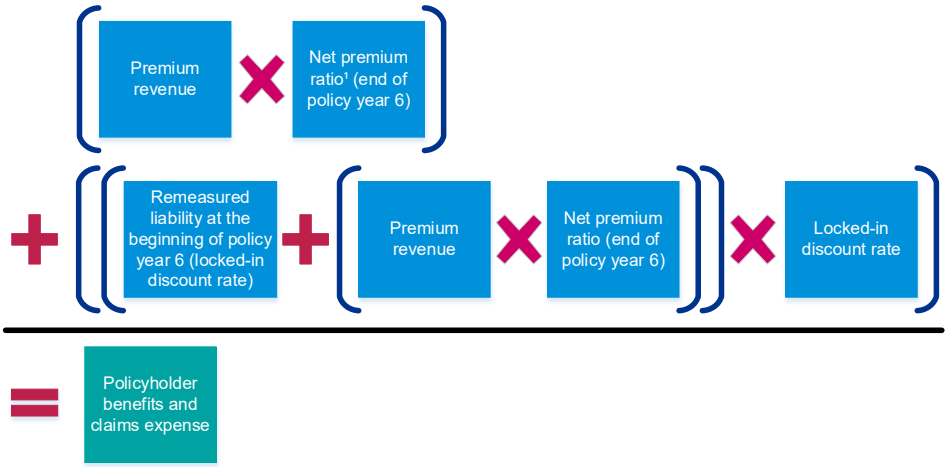
	Debit	Credit
Cash	87,500	
Premium revenue		87,500
Liability for future policy benefits and claims	112,500	
Cash		112,500
To record the entry for the gross premiums collected and cash disbursements for benefits and claims for Policy Year 6.		

Determine current-period activity – Policyholder benefits and claims

Life Insurer calculates the remaining activity for Policy Year 6.

Life Insurer calculates the expense for policyholder benefits and claims of $95,073 (sum of the net premiums and interest accretion) as follows:

- net premiums (the amount required to cover policyholder benefits and claims) of $87,500 ($87,500 × 100%).
- interest accretion at the locked-in discount rate of $7,573 [($63,968 + (87,500 × 100%)) × 5%].



Note:

1. Ratio of net premiums to gross premiums is equal to 100%.

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Life Insurer records the following journal entry.

	Debit	Credit
Policyholder benefits and claims expense	95,073	
Liability for future policy benefits and claims		95,073
Calculated as $87,500 + $7,573		

Calculate OCI

Life Insurer calculates the AOCI balance at the end of Policy Year 6 and records the change for the year as follows. The AOCI balance is the change in discount rates from the locked-in discount rate to the current discount rate.

Change in AOCI at the end of Policy Year 6	
Liability at end of Policy Year 6 (using current discount rate of 4%)	50,819
Less: Liability at end of Policy Year 6 (using locked-in discount rate of 5%)	46,541
AOCI balance at end of Policy Year 6 (debit balance) ($50,819 – $46,541)	4,278
AOCI balance recorded at transition (end of prior period) (debit balance)	2,821
Change in AOCI for Policy Year 6 ($4,278 – $2,821)	1,457

Life Insurer records the following journal entry.

	Debit	Credit
OCI	1,457	
Liability for future policy benefits and claims		1,457
To record entry for the change in AOCI for Policy Year 6.		

Summarized journal entry

At the end of Policy Year 6 (one year after transition), Life Insurer records the following summarized journal entry.

	Debit	Credit
Policyholder benefits and claims expense	95,073	
Remeasurement loss	3,113	
OCI	1,457	
Liability for future policy benefits[1]	12,857	
Cash		25,000
Premium revenue		87,500
To record entry to update liability for future policy benefits at end of Year 6 (one year after adoption).		

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Notes:
1. $14,314[2] – 1,457
2. $14,314 = 112,500 – 3,113 – 95,073

Life Insurer separately discloses the effect of remeasuring the net premium ratio on the present value of expected net premiums and the present value of expected future policy benefits in the respective sections of the tabular rollforward disclosure of the liability for future policy benefits.

For additional discussion about remeasurement gain (loss), see section 2.3. For additional discussion about disclosures, see chapter 6.

Example 2.2.40 Remeasurement of liability for future policy benefits – net premium ratio reduced below 100%**

Assume the same facts as in Example 2.2.30 except that Life Insurer is at the end of Policy Year 7 (two years after transition). As illustrated in Example 2.2.30 the net premium ratio at the end of Policy Year 6 was capped at 100%.

End of Policy Year 7

Update cash flows

During Policy Year 7, Life Insurer has $92,500 of actual Year 7 claim experience, which is lower-than-expected. Additionally, Life Insurer revises its best estimates of the future cash flows for the remaining policy years. At the end of Policy Year 7, Life Insurer updates its projected future cash flows as follows.

Projected future cash flows				
Policy year	Projected premiums – end of Policy Year 6	Projected claims – end of Policy Year 6	Actual and projected premiums – updated	Actual and projected claims – updated
7	85,000	95,000	85,000	92,500
8	82,500	97,500	82,500	97,000
9	80,000	100,000	80,000	99,500
10	77,500	102,500	77,500	102,000

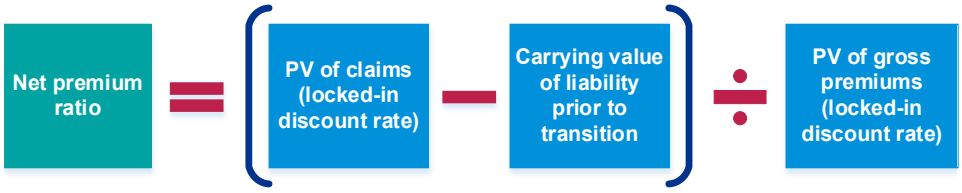
Recalculate net premium ratio

Life Insurer calculates the present value of the updated projected future cash flows as of the beginning of Policy Year 6 (the transition date) using the locked-in discount rate (5%) to recalculate the net premium ratio as of that date as follows.

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Present value of historical actuals and projected future cash flows	
Cash flows	**At locked-in discount rate (5%)**
Projected gross premium cash flows (actual gross premiums for Years 6 and 7 and projected gross premiums for Years 8 to 10)	376,149
Projected claim cash flows (actual claims for Years 6 and 7 and projected claims for Years 8 to 10)	436,614

At the end of Policy Year 7, Life Insurer uses the present value of historical actuals and projected future cash flows to recalculate the net premium ratio as of the beginning of Policy Year 6 (the transition date) of 99.90% [($436,614 – $60,855) ÷ $376,149] as follows.



The net premium ratio at the end of Policy Year 6 was capped at 100%. The cap is applied based on the facts and circumstances at each reporting date. If updated actual experience or revised future cash flow estimates improve profitability, the recalculated net premium ratio may fall below 100%, eliminating the need for the cap and potentially resulting in a remeasurement gain. At the end of Policy Year 7, Life Insurer recalculates the net premium ratio at 99.90%. Therefore, Life Insurer no longer needs to cap the net premium ratio when calculating the liability.

Determine liability

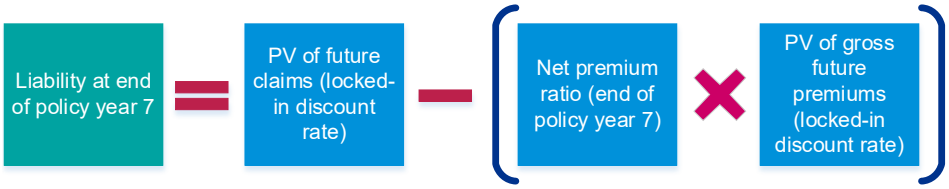
Life Insurer calculates the present value of updated projected future cash flows at the end of Policy Year 7 using the locked-in discount rate (5%) and the current discount rate at the end of Policy Year 7 (3.5%) to calculate the liability for future policy benefits at the end of Policy Year 7 as follows.

Present value of projected future cash flows		
Cash flows	**At locked-in discount rate (5%)**	**At current Policy Year 7 discount rate (3.5%)**
Projected gross premium cash flows (projected gross premiums for Years 8 to 10)	228,985	232,142
Projected claim cash flows (projected claims for Years 8 to 10)	270,750	278,611

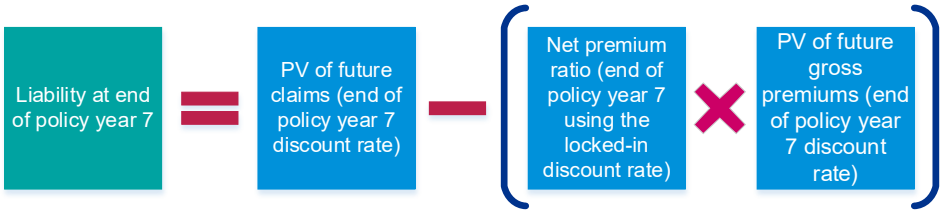
Life Insurer then uses the end of Policy Year 7 recalculated net premium ratio as of the beginning of Policy Year 6 (the transition date) and the present value of projected future cash flows at the end of Policy Year 7 to calculate the liability for future policy benefits at the end of Policy Year 7.

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Using the locked-in discount rate of 5%, the liability for future policy benefits at the end of Policy Year 7 is $41,994 [$270,750 – (99.90% × $228,985)], calculated as follows.



Using the current discount rate of 3.50% at the end of Policy Year 7, the liability for future policy benefits is $46,701 [$278,611 – (99.90% × $232,142)], calculated as follows.



Life Insurer calculates the change in the liability for future policy benefits for the current period at the locked-in discount rate to determine the amount of the change recorded in the income statement.

Change in liability (Policy Year 7) at locked-in discount rate	
Liability at end of Policy Year 7 (using locked-in discount rate of 5%)	41,994
Less: Liability at end of prior year (using locked-in discount rate of 5%)	46,541
Change in liability balance for the period ($41,994 – $46,541)	(4,547)

Remeasurement gain

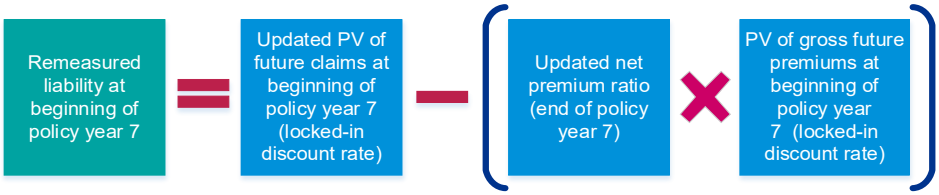
The remeasurement gain is the amount that Life Insurer records in the current period for the change in the liability as of the beginning of the current period because of the favorable update of the projected cash flows (historical actuals and cash flow assumption update) and the net premium ratio dropping below 100%. This gain is recognized independent of whether cash flow assumptions were updated because it represents, in part, the recovery of the remeasurement loss recorded in Policy Year 6 when the net premium ratio was capped at 100%.

Life Insurer calculates the present value of the updated projected future cash flows at the beginning of Policy Year 7 using the locked-in discount rate (5%) for use when performing the calculation of the remeasurement gain as of the beginning of Policy Year 7 as follows.

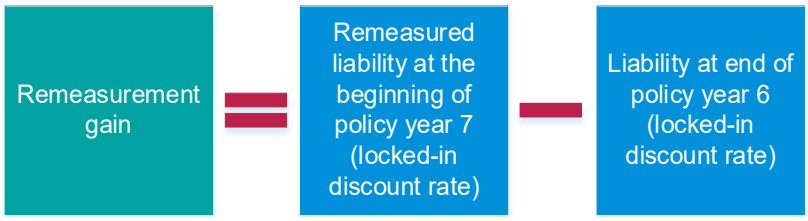
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Historical actuals and present value of projected future cash flows	
Cash flows	**At locked-in discount rate (5%)**
Projected net premium cash flows (actual gross premiums for Year 7 and projected net premiums for Years 8 to 10)	302,767
Projected claim cash flows (actual claims for Year 7 and projected claims for Years 8 to 10)	345,945

Life Insurer calculates the remeasured liability as of the beginning of Policy Year 7 of $43,178 ($345,945 – $302,767) using the locked-in discount rate of 5% as follows.



Life Insurer calculates the remeasurement gain of $3,363 ($43,178 – $46,541) as follows.



Life Insurer records the following journal entry to recognize the remeasurement gain.

	Debit	Credit
Liability for future policy benefits and claims	3,363	
Remeasurement gain		3,363
To record entry for the remeasurement gain to recognize changes in net premium ratio and projected cash flow assumptions as of the beginning of current reporting period (i.e. catch-up method).		

Determine current-period activity – Premiums and claims

Life Insurer records the following journal entries for Policy Year 7 gross premiums collected (premium revenue) and cash disbursement for benefits and claims.

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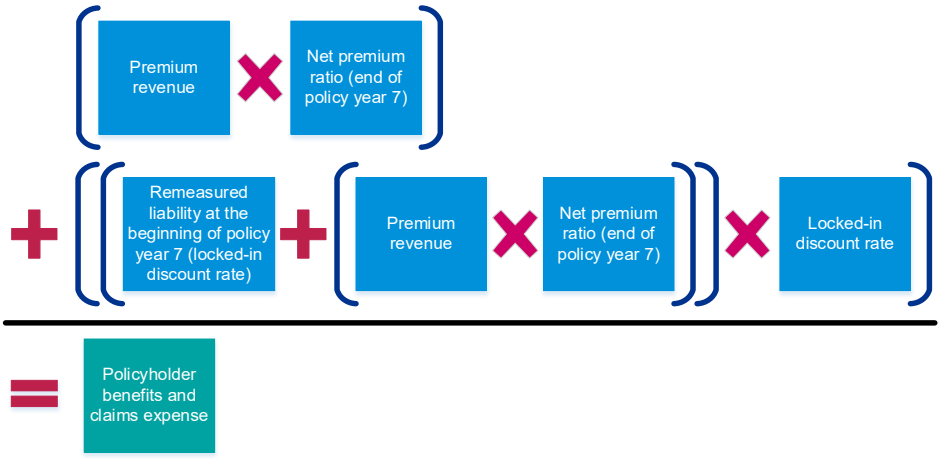
	Debit	Credit
Cash	85,000	
Premium revenue		85,000
Liability for future policy benefits and claims	92,500	
Cash		92,500
To record entry for the gross premiums collected and cash disbursements for benefits and claims for Policy Year 7.		

Determine current-period activity – Policyholder benefits and claims

Life Insurer calculates the remaining activity for Policy Year 7.

Life Insurer calculates the expense for policyholder benefits and claims of $91,316 (sum of the net premiums and interest accretion) as follows:

- net premiums (the amount required to cover policyholder benefits and claims) of $84,912 ($85,000 × 99.90%), plus
- interest accretion at the locked-in discount rate of $6,404 [($43,178 + ($85,000 × 99.90%)) × 5%].



Life Insurer records the following journal entry.

	Debit	Credit
Policyholder benefits and claims expense	91,316	
Liability for future policy benefits and claims		91,316
Calculated as $84,912 + $6,404		

Calculate OCI

Life Insurer calculates the AOCI balance at the end of Policy Year 7 and records the change for the year as follows. The AOCI balance is the change in discount rates from the locked-in discount rate to the current discount rate.

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Change in AOCI at the end of Policy Year 7	
Liability at end of Policy Year 7 (using current discount rate of 3.5%)	46,701
Less: Liability at end of Policy Year 7 (using locked-in discount rate of 5%)	41,994
AOCI balance at end of Policy Year 7 (debit balance) ($46,701 – $41,994)	4,707
AOCI balance recorded at end of Policy Year 6 (debit balance)	4,278
Change in AOCI for Policy Year 7 ($4,707 – $4,278)	429

Life Insurer records the following journal entry.

	Debit	Credit
OCI	429	
Liability for future policy benefits and claims		429
To record entry for the change in AOCI for Policy Year 7.		

Summarized journal entry

At the end of Policy Year 7, Life Insurer records the following summarized journal entry.

	Debit	Credit
Policyholder benefits and claims expense	91,316	
OCI	429	
Liability for future policy benefits[1]	4,118	
Cash		7,500
Remeasurement gain		3,363
Premium revenue		85,000
To record entry to update liability for future policy benefits at end of Year 7 (two years after adoption).		

Notes:
1. $4,547[2] – 429
2. $4,547 = $92,500 + 3,363 – 91,316

Life Insurer separately discloses the effect of remeasuring the net premium ratio on the present value of expected net premiums and the present value of expected future policy benefits in the respective sections of the tabular rollforward disclosure of the liability for future policy benefits.

For additional discussion about remeasurement gain (loss), see section 2.3. For additional discussion about disclosures, see chapter 6.

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2.3 Cash flow assumptions

2.3.10 Reviewing and updating cash flow assumptions

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

35-5 Assumptions shall be updated in subsequent accounting periods as follows to determine changes in the **liability for future policy benefits**:

a. Cash flow assumptions (that is, the assumptions used to derive estimated cash flows, including the **mortality**, **morbidity**, **termination**, and expense assumptions referenced in paragraphs 944-40-30-11 through 30-15) shall be reviewed—and if there is a change, updated—on an annual basis, at the same time every year.
   1. Cash flow assumptions shall be updated in interim reporting periods if evidence suggests that cash flow assumptions should be revised.

An entity reviews its cash flow assumptions to determine cash flow estimates on an annual basis at the same time every year. After the review, if there is a change in cash flow assumptions, they are updated. An entity makes more frequent updates when evidence suggests that the cash flow assumptions need to be revised. [944-40-35-5]

Question 2.3.10 Does an entity have to review cash flow assumptions at the same time each year for every product line?

Interpretive response: No. ASU 2018-12 requires an entity to review cash flow assumptions annually at the same time every year. It does not require that cash flow assumptions be reviewed for all product lines at the same time. [944-40-35-5]

We believe an entity can elect to review the cash flow assumptions for different product lines at different times during the year. For example, an entity may review its cash flow assumptions for term life contracts in Q2 and disability contracts in Q3. However, we believe an entity should review all product lines in the same (dis)aggregated rollforward at the same time. [944-40-35-5]

We believe the timing of an entity's cash flow assumptions review is an accounting policy because ASU 2018-12 requires it to be performed at the same time every year. We believe a change to the timing of the cash flow assumptions review is a change in accounting principle under Topic 250, and an entity should not change its policy unless it is preferable. For further guidance, see section 3.3 of KPMG Handbook, Accounting changes and error corrections. [944-40-35-5, 250-10-45-2]

For guidance on the (dis)aggregation of rollforwards, see section 6.5.

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Question 2.3.20 Can an entity update its cash flow assumptions more frequently than annually?

Interpretive response: Yes. We believe an entity can elect to update its cash flow assumptions more frequently than annually. For example, an entity may find it operationally effective to update for actual cash flows and review cash flow assumptions for possible updates each quarter. [944-40-35-5]

Observation Frequency of cash flow assumption updates

The financial statements of an entity that elects to update its net premium ratio (for actual cash flows and reevaluated future cash flow assumptions) each reporting period, consistent with its updating of insurance in force, will reflect a better matching of experience variances in the reporting period in which they occur when compared to an entity that elects to update its net premium ratio less frequently. [944-40-35-5]

Question 2.3.30 Does an entity evaluate all of its cash flow assumptions when it unlocks the net premium ratio?

Interpretive response: Yes. When an entity unlocks the net premium ratio to reflect an update to its cash flow assumptions, it reevaluates all assumptions. This includes updating the net premium ratio for actual cash flows, contracts in force and future cash flow assumptions. The evaluation may not require an update to future cash flow assumptions but an entity must validate all unchanged assumptions. Additionally, if an assumption is updated for one contract group, an entity should consider whether evidence is available to indicate that the same assumption should be updated for other contract group(s). [944-40-35-5]

Some entities prepare periodic experience studies to assess historical policyholder behavior on a rolling basis to spread the workload throughout the year – e.g. completing an experience study for mortality in Q2 and morbidity in Q3. In this situation, during the Q2 review of assumptions, an entity assesses all relevant information gathered in the mortality experience study and other cash flow information available for other assumptions (e.g. morbidity), and updates in Q2 if necessary. For further discussion about the review of DAC assumptions, see Question 4.4.70. [944-40-35-5]

Question 2.3.35 Must an entity perform experience studies for interim reporting?

Interpretive response: No. Cash flow assumptions are required to be updated in interim reporting periods if evidence suggests that they should be revised.

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However, an entity is not required to perform experience studies outside of the regularly scheduled annual review. Instead, an entity should consider all information available and have a reasonable basis to conclude that the cash flow assumptions used in the calculation of the liability for future policy benefits are management's best estimates at the interim reporting date. [944-40-35-5]

2.3.20 Actual experience

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

35-6 Actual experience shall be recognized in the period in which that experience arises. The liability for future policy benefits shall then be updated for actual experience at least on an annual basis as described in paragraph 944-40-35-5(a) (and for limited-payment contracts, see paragraph 944-605-35-1B for guidance on updating any corresponding deferred profit liability). An insurance entity need not update the liability for future policy benefits for actual experience more often than on an annual basis, unless cash flow assumptions are updated as described in paragraph 944-40-35-5(a)(1).

Question 2.3.40 How frequently does an entity update for actual experience?

Interpretive response: Actual experience is recognized in the period in which it arises. When calculating the liability for future policy benefits, we believe an entity should use updated insurance in force – e.g. updated for lapses, mortality, and other terminations. This results in the entity recording a liability for policies in force at the end of the period. [944-40-35-6]

However, an entity is not required to update the net premium ratio for actual premiums, benefits and expenses each reporting period unless it unlocks the net premium ratio to change cash flow assumptions. The net premium ratio used to calculate the liability for future policy benefits is updated for actual experience at least annually at the same time every year when cash flow assumptions are reviewed and updated. At interim reporting dates, an entity evaluates whether actual information (including updated insurance in force) suggests that the cash flow assumptions used to calculate the net premium ratio need to be revised. [944-40-35-5(a)(1), 35-6]

For further discussion about evaluating cash flow assumptions when an entity unlocks the net premium ratio, see Question 2.3.30.

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Question 2.3.45 Does an entity evaluate cash flow assumptions when it updates the net premium ratio for actual experience?

Interpretive response: Yes. The net premium ratio is unlocked when an entity updates for actual experience – e.g. actual premiums, benefits and expenses. The net premium ratio used to calculate the liability for future policy benefits is updated for actual experience at least annually at the same time every year. Any time the net premium ratio is unlocked, it is updated for actual experience and the cash flow assumptions are reviewed and updated as needed. [944-40-35-5(a)(1), 35-6]

For further discussion about evaluating cash flow assumptions when an entity unlocks the net premium ratio, see Question 2.3.30.

For further discussion about updating expense assumptions, see Question 2.3.60.

Question 2.3.50 Does an entity update for actual experience when it updates other cash flow assumptions?

Interpretive response: Yes. The net premium ratio is unlocked when an entity updates its cash flow assumptions during the annual process, or more frequently. Any time the net premium ratio is unlocked, it is updated for actual experience. [944-40-35-6]

2.3.30 Expense assumptions

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

• > Assumptions

• • > Expense

30-15 Expense assumptions used in estimating the liability for future policy benefits shall be based on estimates of expected nonlevel costs, such as termination or settlement costs, and costs after the premium-paying period. Renewal expense assumptions shall consider the possible effect of inflation on those expenses. However, expense assumptions shall not include acquisition costs or any costs that are required to be charged to expense as incurred, such as those relating to investments, general administration, policy **maintenance costs**, product development, market research, and general overhead (see paragraph 944-720-25-2).

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> Traditional and Limited-Payment Long-Duration Contracts

35-5…

a. …

2. An insurance entity may make an entity-wide election not to update the expense assumption referenced in paragraph 944-40-30-15.

Expense assumptions are updated similarly to other cash flow assumptions in the net premium model, except that an entity can make an entity-wide election to not update expense assumptions. [944-40-30-15, 35-5(a)(2)]

Question 2.3.60 Does an entity update expense assumptions with all of its other cash flow assumptions?

Interpretive response: It depends. An entity may make an entity-wide policy election not to update expense assumptions when updating cash flow assumptions. Because this election is made on an entity-wide basis, an entity cannot update expense assumptions for some traditional and limited-payment long-duration contracts but not others. If an entity elects to update expense assumptions then it updates them with other cash flow assumptions. [944-40-35-5(a)(2)]

Further, if an entity makes the entity-wide policy election not to update its expense assumptions, it also does not update the net premium ratio for subsequent actual expense experience. Any differences between expense assumptions at contract issuance and actual current reporting period experience are recorded in net income in the current reporting period. [944-40-35-5(a)(2)]

Question 2.3.70 What expenses are included in the liability for future policy benefits calculations?

Interpretive response: Under legacy US GAAP, costs that did not meet the criteria for capitalization in paragraphs 944-30-25-1A – 25-1AA were expensed as incurred. Therefore, those costs were not included in the calculation of net premiums. ASU 2018-12 does not change that guidance. [944-40-30-15]

When estimating the liability for future policy benefits for traditional and limited-payment contracts, an entity includes estimates of nonlevel costs, including termination and settlement costs, and costs after the premium-paying period. An entity considers the possible effect of inflation when estimating renewal expenses. [944-40-30-15]

Expense assumptions do not include the following costs: [944-40-30-15]

- acquisition;
- investment;
- general administration;
- policy maintenance;
- product development;

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- market research; and
- general overhead.

One of the exclusions is policy maintenance costs, which are associated with maintaining records relating to insurance contracts and the processing of premium collections and commissions. Legacy US GAAP did not explicitly exclude these costs. [944-40 Glossary]

Question 2.3.80 Is DAC amortization included in the net premium model?

Interpretive response: No. Acquisition costs, including the amortization of DAC, are not included in the expense assumptions for the net premium model. [944-40-30-15]

2.3.40 Other cash flow assumption considerations

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

30-7 The **liability for future policy benefits** accrued under paragraph 944-40-25-8 shall be the present value of future benefits to be paid to or on behalf of policyholders and related expenses less the present value of future **net premiums** (portion of **gross premium** required to provide for all benefits and expenses, excluding **acquisition costs** or costs that are required to be charged to expense as incurred). That liability shall be estimated using methods that include assumptions, such as discount rate, **mortality**, **morbidity**, **terminations**, and expenses (see paragraphs 944-40-30-9 and 944-40-30-11 through 30-15). The liability also shall consider other assumptions relating to guaranteed contract benefits, such as coupons, annual endowments, and conversion privileges. The assumptions shall not include a provision for the **risk of adverse deviation**. In determining the level of aggregation at which reserves are calculated, an insurance entity shall not group contracts together from different issue years but shall group contracts into quarterly or annual groups.

Question 2.3.85 What cash outflows are included in calculating the liability for future policy benefits?

Interpretive response: Under legacy US GAAP, the liability for future cash claim payments for a long-duration traditional insurance contract – including disability and long-term care contracts when claims are expected to be paid over an extended period of time after the claim is incurred – consisted of two separate liability components:

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- future policy benefits (claims not yet incurred); and
- unpaid claim and claim adjustment expenses (incurred claims not yet paid).

Under ASU 2018-12, an entity calculates a single liability for future policy benefits that comprises all expected cash flows under the contract, including expected future cash flow payments for claims incurred. This means that the cash flows included in the liability for future policy benefits calculation should reflect the expected final cumulative benefit amount.

This final cumulative benefit amount includes estimated future benefits, claim liabilities, liabilities for claims in the course of settlement, liabilities for incurred but not reported claims, and actual benefits paid. Additionally, when measuring the single liability for future policy benefits and calculating interest accretion, the discount rate assumption (locked-in and current) is used to discount all expected cash flows, including those cash flows for claims incurred. This single liability eliminates the need for a separate claims liability calculation. [944-40-25-8, 25-11, 30-7, 35-6A]

For guidance on balance sheet presentation, see Question 2.7.20.

Question 2.3.90 Can the cash flow assumptions include PADs?

Interpretive response: No. An entity does not include PADs when calculating the liability for future policy benefits for traditional and limited-payment long-duration contracts. The liability for future policy benefits and the net premium ratio are based on best estimates of cash flows without a PAD. [944-40-30-7]

Question 2.3.110 Do adjustable premiums affect the net premium ratio?

Interpretive response: Yes. The net premium ratio includes an entity's estimate of expected premium cash flows. These cash flows include an expectation about the amount and timing of the effect of adjustable premium contract features. [944-40-30-7]

2.3.50 Recognizing changes in assumptions

Excerpt from ASC 944-40

General

> Claim Costs

35-1 Changes in estimates of **claim** costs resulting from the continuous review process and differences between estimates and payments for claims shall be recognized in income of the period in which the estimates are changed or payments are made.

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Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

35-6A A related charge or credit to net income (see paragraph 944-40-45-4) or other comprehensive income as a result of updating assumptions at the level of aggregation at which reserves are calculated (that is, for a group of contracts) shall be determined as follows:

a. Cash flow assumptions. **Net premiums** shall be updated for cash flow changes. An insurance entity shall update its estimate of cash flows expected over the entire life of a group of contracts using actual historical experience and updated future cash flow assumptions. An insurance entity shall recalculate net premiums by comparing the present value of actual historical benefits and related actual (if applicable) historical expenses plus updated remaining expected benefits and related expenses, less the liability carryover basis (if applicable), with the present value of actual historical gross premiums plus the updated remaining expected gross premiums (see Examples 6 and 7 in paragraphs 944-40- 55-29H through 55-29U). The revised ratio of net premiums to gross premiums shall not exceed 100 percent (see paragraph 944-40-35-7A).
    1. Liability remeasurement gain or loss. The revised net premiums shall be used to derive an updated liability for future policy benefits as of the beginning of the current reporting period, discounted at the original (that is, contract issuance) discount rate. The updated liability for future policy benefits as of the beginning of the current reporting period shall then be compared with the carrying amount of the liability as of that date (that is, before the updating of cash flow assumptions) to determine the current period change in liability estimate (that is, the liability remeasurement gain or loss) to be recognized in net income for the current reporting period (see paragraph 944-40-45-4 for presentation requirements).
    2. Current-period benefit expense. The revised net premiums shall be applied as of the beginning of the current reporting period to derive the benefit expense for the current reporting period (see paragraph 944-40-45-4 for presentation requirements).
    3. Subsequent periods. In subsequent periods, the revised net premiums shall be used to measure the liability for future policy benefits, subject to future revisions.
b. Discount rate assumptions. Net premiums shall not be updated for discount rate assumption changes.
    1. The difference between the updated carrying amount of the liability for future policy benefits (that is, the present value of future benefits and expenses less the present value of future net premiums based on updated cash flow assumptions) measured using the updated discount rate assumption and the original discount rate assumption shall be recognized directly to other comprehensive income (that is, on an immediate basis).
    2. The interest accretion rate shall remain the original discount rate used at contract issue date.

> Implementation Guidance

• > Liability for Future Policy Benefits

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• • > Cash Flow Assumption Updating

55-13A Paragraphs 944-40-35-5 through 35-6A and 944-40-35-7A through 35-7B require an insurance entity to review—and if there is a change, update—cash flow assumptions used in estimating the **liability for future policy benefits** at the level of aggregation at which reserves are calculated. Example 6 (beginning in paragraph 944-40-55-29H) illustrates the calculation of the liability, including subsequent changes in the estimate of the liability.

55-13B If the adjustment related to updating cash flow assumptions is an unfavorable adjustment because of expected **net premiums** exceeding expected **gross premiums** (that is, expected benefits and related expenses exceed expected gross premiums), the insurance entity should:

a. Set net premiums equal to gross premiums
b. Increase the estimate of the liability for future policy benefits as of the beginning of the current reporting period
c. Recognize a corresponding adjustment to net income for the current reporting period (see paragraph 944-40-45-4)
d. Disclose qualitative and quantitative information related to adverse development (see paragraph 944-40-50-6(d))
e. Accrue the liability for future policy benefits with net premiums being set equal to gross premiums (that is, a ratio of net premiums to gross premiums equal to 100 percent) until assumptions are subsequently updated.

55-13C If the adjustment related to updating cash flow assumptions is an unfavorable adjustment but does not result in net premiums exceeding gross premiums, then the insurance entity should:

a. Increase the estimate of the liability for future policy benefits as of the beginning of the current reporting period
b. Recognize a corresponding change in estimate adjustment to net income for the current reporting period (see paragraph 944-40-45-4)
c. Accrue the liability for future policy benefits with the revised ratio of net premiums to gross premiums until assumptions are subsequently updated.

55-13D If the adjustment related to updating cash flow assumptions is a favorable adjustment—including the reversal of previously recognized unfavorable adjustment described in paragraph 944-40-55-13B or 944-40-55-13C—the insurance entity should:

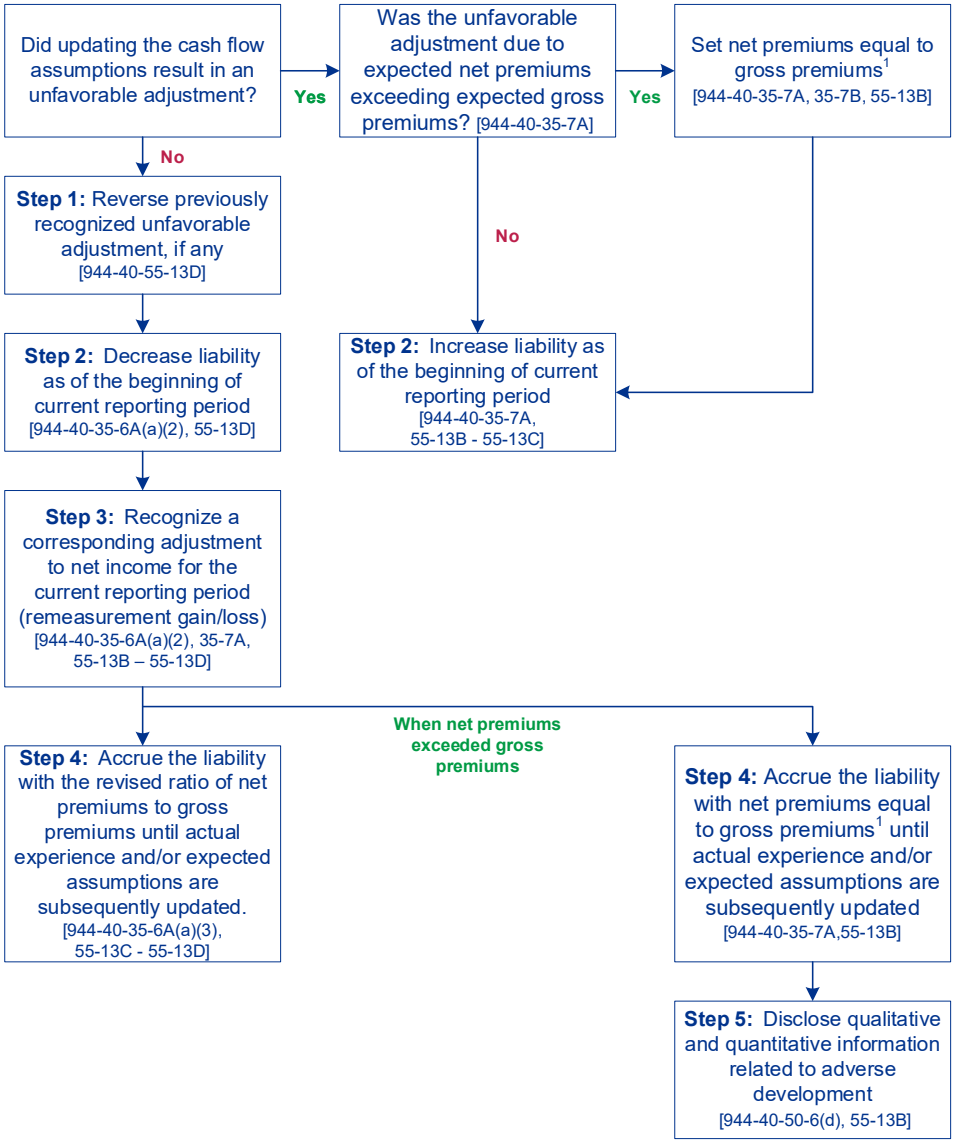
a. Decrease the estimate of the liability for future policy benefits as of the beginning of the current reporting period
b. Recognize a corresponding change in estimate adjustment to net income for the current reporting period (see paragraph 944-40-45-4)
c. Accrue the liability for future policy benefits with the revised ratio of net premiums to gross premiums until assumptions are subsequently updated.

An entity recognizes the effect of updates for actual experience and/or changes in cash flow assumptions in net income using the catch-up method at the level of aggregation that the liability for future policy benefits is calculated. This catch-up method results in the remeasurement gain (loss). [944-40-35-6A]

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Question 2.3.120 How is the liability for future policy benefits updated for changes in cash flow assumptions?

Interpretive response: Updating cash flow assumptions for actual experience or changes in future expectations will result in favorable or unfavorable adjustments to the liability for future policy benefits. The following decision tree shows the steps to update the liability for future policy benefits.



Note:

1. A ratio of net premiums to gross premiums equal to 100%.

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Question 2.3.130 Can the revised net premium ratio exceed 100%?

Interpretive response: No. The revised ratio of net premiums to gross premiums cannot exceed 100%. [944-40-35-6A(a)]

For additional discussion about loss contracts, see section 2.3.60.

For additional discussion about the discount rate causing the liability for future policy benefits to be less than zero, see Question 2.4.140.

Question 2.3.140 How does an entity calculate the liability remeasurement gain (loss)?

Interpretive response: An entity first revises net premiums to calculate an updated liability for future policy benefits as of the beginning of the current reporting period. This liability is calculated using the locked-in discount rate at contract issuance. [944-40-35-6A(a)]

The updated liability is compared with the carrying amount of the liability (i.e. the liability for future policy benefits recorded as of the beginning of the current reporting period before actual experience or any expected assumptions are updated). The difference between these amounts is the remeasurement gain (loss) that is recognized in net income in the current reporting period. [944-40-35-6A(a)]

For guidance on the remeasurement gain (loss), see Examples 2.2.30 and 2.2.40.

Question 2.3.145 Does an entity record a remeasurement gain (loss) in a period in which the net premium ratio is not revised?

Interpretive response: No. An entity records a remeasurement gain (loss) only in periods in which the net premium ratio is revised and used to calculate the liability for future policy benefits at the beginning of the reporting period. This updated liability for future policy benefits is then used to calculate the remeasurement gain (loss) at the beginning of the reporting period. [944-40-35-6A(a)]

An entity updates the net premium ratio used to calculate the liability for future policy benefits for actual experience at least annually at the same time every year. Additionally, at the same time that it updates for actual experience, an entity reviews its cash flow assumptions and updates them as needed. [944-40-35-5, 35-6A(a)]

For further discussion about the calculation of the remeasurement gain (loss), see Question 2.3.140.

For further discussion about evaluating cash flow assumptions when an entity unlocks the net premium ratio, see Question 2.3.30.

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Question 2.3.150 What is the 'beginning of the current reporting period' when updating the net premium ratio?

Interpretive response: The beginning of the current reporting period means the first day after the previous financial results have been reported. [944-40-35-6A(a)(1), 270-10-45-14]

For example, SEC Registrant has a calendar year-end. When preparing its interim financial statements for Q3 Year 2, Registrant calculates the remeasurement gain (loss) on July 1, Year 2 because that is the beginning of the current reporting period. The remeasurement gain (loss) for the nine-month period ended September 30, Year 2 is the sum of the quarterly remeasurement gains and losses. This is consistent with the guidance for a change in accounting estimate during interim periods in Topic 270 (interim reporting). [270-10-45-17]

However, if a non-SEC registrant's current reporting period is the annual reporting period ending December 31, Year 2, the beginning of that reporting period is: [944-40-35-6A(a)(1), 270-10-45-14]

- January 1, Year 2 when only annual financial statements are prepared.
- October 1, Year 2 when quarterly financial information is prepared.

Question 2.3.160 Are net premiums updated for changes in the discount rate assumption?

Interpretive response: No. An entity does not update net premiums for changes in discount rate assumptions. Net premiums are determined using the locked-in discount rate. [944-40-35-6A(b)]

For discussion about updating the discount rate, see section 2.4.20.

Question 2.3.170 Can an entity recapture a previous loss for a contract group if conditions improve?

Interpretive response: Yes. An entity may have previously calculated a net premium ratio greater than 100% and set its net premium ratio so that net premiums equaled gross premiums. If actual cash flows are more favorable than expected or if expected cash flows improve, the entity recognizes a favorable adjustment in the income statement through the remeasurement process. This favorable adjustment includes the reversal of previously recognized unfavorable adjustments.

An entity recognizes the favorable adjustment through a decrease in the liability for future policy benefits and a corresponding adjustment to net income for the current reporting period. [944-40-55-13D]

For further discussion about updating the liability for future policy benefits, see Question 2.3.120.

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For guidance on the remeasurement gain (loss) when the net premium ratio is reduced below 100%, see Example 2.2.40.

See Question 2.3.200 for guidance on determining the 'carrying value of liability prior to transition' used to calculate the net premium ratio subsequent to transition when a loss is recorded at transition because the net premium ratio was greater than 100%.

Question 2.3.175 What contract issue date is used for actual cash flows and any cash flow assumption updates for contracts in force at transition when the modified retrospective transition method is elected?

Interpretive response: When an entity updates actual cash flows and any expected cash flow assumptions used to measure the liability for future policy benefits, it recalculates the net premium ratio as of the contract issue date. It uses this recalculated net premium ratio to remeasure the liability for future policy benefits and calculate the resulting remeasurement gain (loss) as of the beginning of the current reporting period. [944-40-35-6A]

When an entity used the modified retrospective transition method and is recalculating the net premium ratio for those contracts that were in force at transition, the contract issue date used to recalculate the net premium ratio is the transition date. It is not the original contract issue date. [944-40-35-6A, 65-2(d)(5)]

For further discussion about updating the liability for future policy benefits, see Question 2.3.120. For further discussion about the calculation of the remeasurement gain (loss), see Question 2.3.140.

2.3.60 Loss contracts

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

30-7A To the extent the present value of future benefits and expenses exceeds the present value of future gross premiums, an immediate charge shall be recognized in net income (see paragraph 944-40-45-4) such that net premiums are set equal to gross premiums. In no event shall the liability for future policy benefits balance be less than zero for the level of aggregation at which reserves are calculated. Assumptions shall be updated in subsequent accounting periods as described in paragraphs 944-40-35-5 through 35-6A and 944-40-35-7A through 35-7B.

35-7A If the updating of cash flow assumptions results in the present value of future benefits and expenses exceeding the present value of future gross premiums, an insurance entity shall:

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a. Set net premiums equal to gross premiums
b. Increase the liability for future policy benefits
c. Recognize a corresponding charge to net income for the current reporting period (see paragraph 944-40-45-4) such that net premiums are set equal to gross premiums.

In subsequent periods (that is, until assumptions are subsequently updated), the liability for future policy benefits shall be accrued with net premiums set equal to gross premiums.

35-7B In no event shall the liability for future policy benefits balance be less than zero at the level of aggregation at which reserves are calculated.

The liability for future policy benefits cannot be less than zero. When net premiums are greater than gross premiums – i.e. the net premium ratio is greater than 100% – the net premiums are set equal to gross premiums. [944-40-30-7A]

Question 2.3.180 Can an entity record a negative liability for future policy benefits on an individual contract group?

Interpretive response: No. Even if mathematically the net premium model calculates a negative liability for future policy benefits, the liability cannot be less than zero at the contract group level used to calculate the liability. [944-40-30-7A, 35-7B]

For additional discussion about the discount rate causing the liability for future policy benefits to be less than zero, see Question 2.4.140.

For guidance about the transition carrying value used to calculate the net premium ratio subsequent to transition when a loss was recorded at transition because the:

- net premium ratio was greater than 100%, see Question 2.3.200.
- liability for future policy benefits was floored at zero, see Question 2.3.210.

Question 2.3.190 What happens when the net premium ratio is greater than 100%?#

Interpretive response: An entity recognizes an immediate charge in net income to reflect the amount needed for net premiums to equal gross premiums when the mathematical result of the net premium ratio for contracts issued: [944-40-30-7A, 35-7A, 65-2(d)(2)]

- subsequent to transition is that the present value of future benefits and expenses is greater than the present value of future gross premiums.
- prior to transition is that the present value of future benefits and expenses less the carrying amount of the liability immediately prior to transition is greater than the present value of future gross premiums.

The liability for future policy benefits can never be less than zero for the level of aggregation at which the liability is calculated. [944-40-35-7B]

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In some cases, an entity evaluates the 100% limit on the net premium ratio at a lower level under ASU 2018-12 as compared to premium deficiency testing under legacy US GAAP. Under ASU 2018-12, contract groups with net premium ratios less than 100% cannot be used to offset contract groups with net premium ratios greater than 100%. Under legacy US GAAP, those contract groups may have been evaluated together resulting in no loss recognition or a smaller loss recognition.

For guidance on the remeasurement gain (loss) when the net premium ratio is greater than 100%, see Example 2.2.30.

For additional discussion about the discount rate causing the liability for future policy benefits to be less than zero, see Question 2.4.140.

Question 2.3.200 What transition carrying value is used to calculate the net premium ratio when a loss was recorded at transition because net premiums exceeded gross premiums?

Interpretive response: In periods subsequent to transition, we believe that the 'carrying value of liability prior to transition' used to calculate the net premium ratio is the carrying value at transition prior to any adjustment that was recorded to retained earnings because the expected ratio of net premiums to gross premiums for a contract group exceeded 100%.

Therefore, any adjustment to opening retained earnings at transition because the expected ratio of net premiums to gross premiums for a contract group exceeded 100% is not included in the 'carrying value of liability prior to transition' in subsequent net premium ratio calculations.

For guidance on the recalculation of the net premium ratio subsequent to transition, see Example 2.2.20.

For guidance on the expected ratio of net premiums to gross premiums exceeding 100% at transition, see Question 7.3.70.

Question 2.3.210 What transition carrying value is used to calculate the net premium ratio when a loss was recorded at transition because the liability for future policy benefits was floored at zero?

Interpretive response: In periods subsequent to transition, we believe that the 'carrying value of liability prior to transition' used to calculate the net premium ratio is the carrying value at transition prior to any adjustment that was recorded to retained earnings because the liability was floored at zero for a contract group.

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Therefore, any adjustment to opening retained earnings at transition because the liability was floored at zero is not included in the 'carrying value of liability prior to transition' in subsequent net premium ratio calculations.

For guidance on the recalculation of the net premium ratio subsequent to transition, see Example 2.2.20. For guidance on recording a negative liability for future policy benefits on an individual contract group, see Question 2.3.180.

For guidance on how the reinsurance recoverable is affected by the requirement that the liability is floored at zero for direct insurance contracts, see Question 2.5.230.

2.4 Discount rate

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

• > Assumptions

• • > Discount Rate

30-9 The liability for future policy benefits shall be discounted using an upper-medium grade (low-credit-risk) fixed-income instrument yield. An insurance entity shall consider reliable information in estimating the upper-medium grade (low-credit-risk) fixed-income instrument yield that reflects the duration characteristics of the liability for future policy benefits (see paragraph 944-40-55-13E). An insurance entity shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs in determining the discount rate assumption.

> Implementation Guidance

• > Liability for Future Policy Benefits

• • > Discount Rate

55-13E An insurance entity should maximize the use of current observable market prices of upper-medium-grade (low-credit-risk) fixed-income instruments with durations similar to the liability for future policy benefits.

a. An insurance entity should not substitute its own estimates for observable market data unless the market data reflect transactions that are not orderly (see paragraphs 820-10-35-54I through 35-54J for additional guidance on determining whether transactions are not orderly).
b. In determining points on the yield curve for which there are limited or no observable market data for upper-medium-grade (low-credit-risk) fixed-income instruments, an insurance entity should use an estimate that is consistent with existing guidance on **fair value** measurement in Topic 820, particularly for Level 3 fair value measurement.

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The discount rate for the liability for future policy benefits for traditional and limited-payment long-duration contracts is an upper-medium grade (low-credit-risk) fixed-income instrument yield. This differs from an expected net investment yield that was used under legacy US GAAP. An entity considers relevant observable inputs when determining the discount rate under ASU 2018-12. [944-40-30-9]

An entity updates the discount rate each annual and interim reporting period to measure the liability for future policy benefits as of the reporting date. It recognizes the effect of changes in the rate in OCI. [944-40-35-5(b), 35-6A(b)(1)]

2.4.10 Determine the discount rate

ASU 2018-12 does not specify how an entity should determine the upper-medium grade (low-credit-risk) fixed-income instrument yield, other than to maximize observable inputs. Management applies judgment to determine the expected duration of its liability under the contracts and the discount rate. [944-40-30-9]

Question 2.4.10 What does an upper-medium grade (low-credit-risk) fixed-income instrument yield mean?

Interpretive response: The discount rate specified in ASU 2018-12 is generally interpreted as an A rating. [944-40-30-9, ASU 2018-12.BC60]

We believe A-rated public corporate debt securities in the US market reflect an upper-medium grade (low-credit-risk) fixed-income instrument yield.

Question 2.4.20 What information is used to determine the upper-medium grade (low-credit-risk) fixed-income instrument yield?

Interpretive response: An entity uses observable market data when available. For example, information is generally available in the US market for fixed-income public corporate debt securities that an entity can use to determine the discount rate. Rating agencies also provide rate information that may be helpful. [944-40-30-9, 55-13E]

An entity may consider the way it develops a yield curve for pension liabilities, because this process may provide insights to developing a yield curve to comply with ASU 2018-12.

Question 2.4.30 Can an entity use an internal investment yield?

Interpretive response: No. An entity uses current observable market prices of upper-medium-grade (low-credit-risk) fixed-income instruments for the discount

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rate assumption. Entity-specific estimates cannot be used in place of observable market data. [944-40-30-9, 55-13E]

An entity cannot use its internal investment yield (which is influenced by the quality of its investment portfolio) because it is obligated to perform on its contractual obligations regardless of its investment portfolio strategy. Using an independent observable market rate provides consistency with the estimated cash flows inherent in the entity's contractual obligation and allows for better comparability among entities. [ASU 2018-12.BC60]

Question 2.4.40 How is the discount rate determined when observable information is limited or unavailable?

Interpretive response: An entity makes estimates to determine the discount rate when observable information is limited or unavailable. The guidance in Topic 820 (fair value measurements) applies if Level 2 or Level 3 fair value measurements are used, including adjusting an observable input for characteristics that are different than those being measured. [944-40-55-13E, ASU 2018-12.BC65]

For further guidance, see section H of KPMG Handbook, Fair value measurement.

Question 2.4.50 Does an entity use a yield curve or a single equivalent yield for its discount rate assumption?

Interpretive response: ASU 2018-12 does not specify how to determine the upper-medium grade (low-credit-risk) fixed-income instrument yield, other than to maximize the use of relevant observable inputs. An entity may select a yield curve, calculate a single equivalent yield, or use another method at contract issuance to reflect the expected duration and timing of the cash flows. [944-40-30-9]

Question 2.4.52 Can an entity use different discount rates for individual contracts within a contract group?

Interpretive response: Yes. We believe an entity can use different discount rates for individual contracts within a contract group. The interest accretion rate is the discount rate used at the contract issue date. An entity could determine that discount rate at the contract issue date of each underlying contract within a contract group – i.e. applied to the expected future cash flows for each contract. Alternatively, it could use a yield curve or single equivalent yield to determine the discount rate for the contract group as a whole. [944-40-35-6A(b)(2)]

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Question 2.4.55 Can an entity update its discount rate for a contract group in subsequent periods prior to establishing the locked-in discount rate?

Interpretive response: Yes. Under ASU 2018-12, the interest accretion rate (the discount rate at the contract issue date) is locked-in for a contract group and used for income statement recognition. We believe that this rate is locked-in upon completion of the contract group.

We believe an entity can refine its discount rate assumption for a contract group before the locked-in rate is established. The established locked-in discount rate should be representative of the contract group as a whole – i.e. changes in the locked-in discount rate are weighted by the additional cash flows or for each individual contract.

For example, assume SEC Registrant has a calendar year-end and has elected a 12-month calendar-year contract grouping period. When preparing its interim financial statements for Q1 Year 1, Registrant determines its locked-in discount rate and measures the liability for future policy benefits. Because Registrant elected a 12-month calendar-year contract grouping period, the locked-in discount rate for that contract grouping has not yet been established – i.e. finalized.

For Q2 Year 1, Registrant may refine its locked-in discount rate (not yet established) to reflect the cumulative Q1 and Q2 interim periods. The change in measurement as a result of the refined discount rate is recorded in the current reporting period – i.e. Q2 Year 1.

Registrant continues refining its locked-in discount rate using a similar approach for Q3 and Q4 until the end of that 12-month calendar-year contract grouping period – i.e. Year 1. At the end of Q4 Year 1, the contract group is established and we do not believe that Registrant can subsequently change the interest accretion rate. This is consistent with the guidance for a change in accounting estimate during interim periods in Topic 270 (interim reporting). [270-10-45-17]

Question 2.4.60 Can an entity change its discount rate or method to determine that rate for an established contract group?

Interpretive response: No. We believe an entity should consistently apply its method to determine the upper-medium grade (low-credit-risk) fixed-income instrument yield.

Under ASU 2018-12, the interest accretion rate remains the original discount rate used at the contract issue date. [944-40-35-6A(b)(2)]

Therefore, once an entity establishes the interest accretion rate for a contract group, we do not believe it can change either the interest accretion rate or its method for determining the interest accretion rate in a subsequent measurement period. Additionally, we do not believe the entity can change the

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method for determining the current discount rate for an established contract group used for balance sheet measurement.

Question 2.4.70 Can an entity use different methodologies to determine its discount rate on a contract group basis?

Interpretive response: ASU 2018-12 does not require a certain method to determine the upper-medium grade (low-credit-risk) fixed-income instrument yield. We believe an entity may choose different methods to determine the discount rate to reflect the expected duration and timing of the cash flows of the contracts on a contract group basis; once selected, it should consistently apply those methods. [944-40-30-9, 250-10-45-1]

However, when establishing new contract groups, an entity determines the discount rate methodology that best reflects the expected duration and timing of the cash flows. We believe this can result in the use of different methodologies between contract groups. [944-40-30-9]

Question 2.4.80 How does an entity determine the discount rate for points beyond the observable yield curve?

Interpretive response: If observable market data is unavailable for upper-medium grade (low-credit-risk) fixed-income instruments with durations long enough to match the duration of the liability for future policy benefits, an entity may use unobservable inputs similar to Level 3 fair value measurements in Topic 820 (see Question 2.4.40). [944-40-55-13E]

For example, an entity has contracts with expected cash flows occurring over 50 years and A-rated corporate rates are not available for all points on the yield curve. An entity uses market observable information where available and develops estimates for the points on the curve that are not available. [944-40-55-13E]

Question 2.4.90 How does an entity select a discount rate for contracts denominated in foreign (non-US) currencies?

Interpretive response: We believe the discount rate for a particular contract group's cash flows should reflect a discount rate where those cash flows occur. It should also reflect the duration characteristics of those expected future cash flows. [944-40-30-9]

If the cash flows occur in a foreign (non-US) country, we believe an entity should look to observable inputs available in that country to determine the

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upper-medium grade (low-credit-risk) fixed-income instrument yield used to discount the liability for future policy benefits.

If the country does not have an active market with observable inputs, an estimate is made following the guidance in Topic 820 for Level 3 fair value measurements by maximizing observable data (see Question 2.4.40). [944-40-30-9, 55-13E]

Example 2.4.10 Interest accretion rate determination

Life Insurer writes five-year term life insurance. Contract and contract group details are as follows.

Contract issue age:	50
Contract face amount:	1,000,000
Contract gross annual premium:	5,000
Number of contracts in the issue year contract group:	10

Life Insurer is in the process of determining the locked-in discount rate at contract issuance for this group of contracts issued subsequent to transition. Life Insurer will use this locked-in discount rate to determine the income statement interest accretion and the net premium ratio throughout the life of the contracts.

ASU 2018-12 requires an entity's discount rate to be an upper-medium grade (low-credit-risk) fixed-income instrument yield that reflects the duration characteristics of the liability for future policy benefits. However, it does not specify how an entity should determine the discount rate, other than to maximize relevant observable inputs (see section 2.4.10). Accordingly, to make its determination, Life Insurer illustrates the interest accretion over the life of the contracts using discount rates developed under three methods – spot rate, forward rate and single equivalent rate.

For illustrative purposes, this example assumes no lapses, no claim settlement expenses, no cash flow assumption updates, and actual experience equal to expected as time progresses. The mortality rates are as follows.

Age	Mortality rate
50	0.003330
51	0.003647
52	0.003980
53	0.004331
54	0.004698

Using these mortality rates and the contract details above, Life Insurer estimates the future cash flows for the contract group at contract issuance as follows.

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Policy year	Gross premiums (beginning of year)	Claims (end of year)
1	50,000	33,300
2	49,833	36,348
3	49,651	39,522
4	49,454	42,837
5	49,239	46,265

At contract issuance, Life Insurer determines the locked-in discount rates for the three methods, based on the upper-medium grade (low-credit-risk) fixed-income instrument yield, as follows (rounded).

Policy year	Spot rate	Forward rate[1]	Single equivalent rate[2]
1	0.579%	0.579%	1.340%
2	0.725%	0.871%	1.340%
3	0.951%	1.405%	1.340%
4	1.137%	1.697%	1.340%
5	1.322%	2.065%	1.340%

Notes:

1. The forward rate for Year 1 is equal to the spot rate for Year 1 by definition. Beginning in Year 2, the one-year forward rate for the period is calculated as:

   $1\ year\ forward\ rate_t = \frac{(1+S_t)^t}{(1+S_{t-1})^{t-1}} - 1$, where

   S_t = The spot rate for year t

   S_{t-1} = The spot rate for year t-1

   For example, the one-year forward rate for Year 2 is calculated as (((1+ 0.725%)^2) ÷ (1+ 0.579%)) – 1.

2. Life Insurer uses the upper-medium grade curve, which can be represented as a series of spot or forward rates, and the expected future cash flows for the contract group at contract issuance to determine the single equivalent rate that equates the initial liability calculated using the upper-medium grade curve to the present value of projected benefits and expenses less the present value of projected net premiums at contract inception.

Using the locked-in discount rates above, Life Insurer determines the discount factors to be used at contract issuance for the three methods as follows (rounded).

Policy year	Spot rate[1]	Forward rate[2]	Single equivalent rate[3]
0	1.00000	1.00000	1.00000
1	0.99424	0.99424	0.98678
2	0.98566	0.98565	0.97373
3	0.97200	0.97199	0.96085
4	0.95578	0.95577	0.94815
5	0.93644	0.93643	0.93561

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Notes:

1. Calculated as (1 ÷ (1+ current year spot rate)$^{(Z-Y)}$) where Z is the policy year and Y is the valuation year. For example, Year 1 is calculated as (1 ÷ (1+ 0.579%)$^{(1-0)}$), and Year 2 is calculated as (1 ÷ (1+ 0.725%)$^{(2-0)}$).
2. Calculated as (prior year discount factor ÷ (1+ current year forward rate)). For example, Year 1 is calculated as (1 ÷ (1+ 0.579%)), and Year 2 is calculated as (0.99424 ÷ (1+ 0.871%)).
3. Calculated as (1÷ (1+ single equivalent rate)$^{(Z-Y)}$) where Z is the policy year and Y is the valuation year. For example, Year 1 is calculated as (1 ÷ (1+ 1.340%)$^{(1-0)}$), and Year 2 is calculated as (1 ÷ (1+ 1.340%)$^{(2-0)}$).

Using the present value of expected future premiums and claims, Life Insurer calculates the net premium ratios under the three methods as follows (rounded).

Method	Net premium ratio
Spot rate[1]	78.655%
Forward rate[2]	78.655%
Single equivalent rate[3]	78.655%

Notes:

1. Calculated as the (present value of expected future claims for Years 1 to 5 using the relevant end-of-year spot rate discount factors) ÷ (present value of expected future gross premiums for Years 1 to 5 using the relevant beginning-of-year spot rate discount factors).
2. Calculated as the (present value of expected future claims for Years 1 to 5 using the relevant end-of-year forward rate discount factors) ÷ (present value of expected future gross premiums for Years 1 to 5 using the relevant beginning-of-year forward rate discount factors).
3. Calculated as the (present value of expected future claims for Years 1 to 5 using the relevant end-of-year single equivalent rate discount factors) ÷ (present value of expected future gross premiums for Years 1 to 5 using the relevant beginning-of-year single equivalent rate discount factors).

Two views that can be considered when measuring the liability for future policy benefits are: a prospective view and a retrospective view (not to be confused with the retrospective transition method or the catch-up method to reflect remeasurement of the liability under ASU 2018-12). The liability for future policy benefits is calculated as follows.

- Under the prospective view, as the present value of future benefits less the present value of future net premiums.
- Under the retrospective view, by starting with the prior-period liability for future policy benefits, adding in the current-period net premium, subtracting the current-period benefits and adding in the current-period interest accretion.

Life Insurer calculates the liability for future policy benefits using both the prospective and retrospective views. The beginning-of-period and end-of-period balances of the liability for future policy benefits are the same under both views. However, the retrospective view provides Life Insurer with greater

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visibility into the components of the liability for future policy benefits, particularly the interest accretion component.

Prospective view

Year 1

At the end of Year 1, expected future premiums and claims are consistent with those projected at contract issuance (no assumption updates) and actual historical premiums and claims are equal to expected. This results in net premium ratios equal to those calculated at contract issuance.

Life Insurer determines the discount factors to be used at the end of Year 1 valuation date for the three methods as follows (rounded).

Policy year	Spot rate[1]	Forward rate[2]	Single equivalent rate[3]
1	1.00000	1.00000	1.00000
2	0.99280	0.99136	0.98678
3	0.98125	0.97762	0.97373
4	0.96665	0.96130	0.96085
5	0.94882	0.94185	0.94815

Notes:

1. Calculated as $(1 \div (1+ \text{current year spot rate})^{(Z-Y)})$ where Z is the policy year and Y is the valuation year. For example, Year 2 is calculated as $(1 \div (1+ 0.725\%)^{(2-1)})$, and Year 3 is calculated as $(1 \div (1+ 0.951\%)^{(3-1)})$.
2. Starting with Year 2, calculated as (prior year discount factor × (1+ current year forward rate)). For example, Year 2 is calculated as (0.98565 × (1+ 0.579%)), and Year 3 is calculated as (0.97199 × (1+0.579%)).
3. Calculated as $(1 \div (1+ \text{single equivalent rate})^{(Z-Y)})$ where Z is the policy year and Y is the valuation year. For example, Year 2 is calculated as $(1 \div (1+ 1.340\%)^{(2-1)})$, and Year 3 is calculated as $(1 \div (1+ 1.340\%)^{(3-1)})$. For each period, these rates are consistent with those determined at contract issuance.

Life Insurer uses the expected future cash flows and each year's discount factor to calculate the liability for future policy benefits as follows (rounded).

Method	Liability for future policy benefits (end of Year 1)
Spot rate[1]	6,599
Forward rate[2]	6,256
Single equivalent rate[3]	6,555

Notes:

1. Calculated as the (present value of expected future claims for Years 2 to 5 using the relevant end-of-year spot rate discount factors) – (Net premium ratio at contract issuance using the spot curve) × (present value of expected future gross premiums for Years 2 to 5 using the relevant beginning-of-year spot rate discount factors).
2. Calculated as the (present value of expected future claims for Years 2 to 5 using the relevant end-of-year forward rate discount factors) – (Net premium ratio at contract issuance using the forward curve) × (present value of expected future

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gross premiums for Years 2 to 5 using the relevant beginning-of-year forward rate discount factors).

3. Calculated as the (present value of expected future claims for Years 2 to 5 using the relevant end-of-year single equivalent rate discount factors) – (Net premium ratio at contract issuance using the single equivalent rate) × (present value of expected future gross premiums for Years 2 to 5 using the relevant beginning-of-year single equivalent rate discount factors).

Year 2

At the end of Year 2, expected future premiums and claims are consistent with those projected at contract issuance (no assumption updates) and actual historical premiums and claims are equal to expected. This results in net premium ratios equal to those calculated at contract issuance.

Life Insurer determines the discount rates to be used at the end of Year 2 valuation date for the three methods as follows (rounded).

Policy year	Spot rate[1]	Forward rate[2]	Single equivalent rate[3]
2	1.00000	1.00000	1.00000
3	0.99058	0.98614	0.98678
4	0.97764	0.96967	0.97373
5	0.96137	0.95005	0.96085

Notes:

1. See spot rate note in end of Year 1 table.
2. See forward rate note in end of Year 1 table.
3. See single equivalent rate note in end of Year 1 table.

Life Insurer uses the expected future cash flows and each year's discount factor to calculate the liability for future policy benefits as follows (rounded).

Method	Liability for future policy benefits (end of Year 2)
Spot rate[1]	10,059
Forward rate[2]	9,500
Single equivalent rate[3]	10,016

Notes:

1. Calculated as the (present value of expected future claims for Years 3 to 5 using the relevant end-of-year spot rate discount factors) – (Net premium ratio at contract issuance using the spot curve) × (present value of expected future gross premiums for Years 3 to 5 using the relevant beginning-of-year spot rate discount factors).
2. Calculated as the (present value of expected future claims for Years 3-5 using the relevant end-of-year forward rate discount factors) – (Net premium ratio at contract issuance using the forward curve) × (present value of expected future gross premiums for Years 3 to 5 using the relevant beginning-of-year forward rate discount factors).
3. Calculated as the (present value of expected future claims for Years 3 to 5 using the relevant end-of-year single equivalent rate discount factors) – (Net premium ratio at contract issuance using the single equivalent rate) × (present value of

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expected future gross premiums for Years 3 to 5 using the relevant beginning-of-year single equivalent rate discount factors).

Life Insurer continues this process for each of the contract's five years.

For an illustration of the liability for future policy benefits and interest accretion for the three methods as of and for each of the five years, see the Comparison between the spot rate, forward rate and single equivalent rate method section below.

Retrospective view

Life Insurer also calculates the liability for future policy benefits using the retrospective view to provide greater visibility into the components of the liability for future policy benefits, particularly the interest accretion component.

Method 1: Spot rate

Policy year	Liability for future policy benefits (beginning of year)	Net premium[1]	Interest accretion[2]	Death claims[3]	Liability for future policy benefits[4] (end of year)
1	0	39,328	571	33,300	6,599
2	6,599	39,196	612	36,348	10,059
3	10,059	39,053	640	39,522	10,230
4	10,230	38,898	641	42,837	6,932
5	6,932	38,729	604	46,265	0

Notes:

1. Net premium for each year is calculated as the annual gross premium × net premium ratio. For example, Year 1 is calculated as $50,000 × 78.655%, and Year 2 is calculated as $49,833 × 78.655%
2. Interest accretion for each year is calculated using the spot curve.
3. See claims column in the estimated future cash flow table at the beginning of the example.
4. Liability for future policy benefits at the end of the year is calculated as the liability for future policy benefits at the beginning of the year + net premium + interest accretion – death claims.

Method 2: Forward rate

Policy year	Liability for future policy benefits (beginning of year)	Net premiums[1]	Interest accretion[2]	Death claims[3]	Liability for future policy benefits (end of year)[4]
1	0	39,328	228	33,300	6,256
2	6,256	39,196	396	36,348	9,500
3	9,500	39,053	682	39,522	9,713

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Policy year	Liability for future policy benefits (beginning of year)	Net premiums[1]	Interest accretion[2]	Death claims[3]	Liability for future policy benefits (end of year)[4]
4	9,713	38,898	825	42,837	6,599
5	6,599	38,729	937	46,265	0

Notes:

1. See 'Net premium' note in Method 1: Spot rate table.
2. Interest accretion for each year is calculated as the (liability for future policy benefits at the beginning of the year + net premium) × forward interest rate for the year, rounded. For example, Year 1 interest accretion is calculated as ($0 + $39,328) × 0.579%, and Year 2 is calculated as ($6,256 + $39,196) × 0.871%.
3. See claims column in the estimated future cash flow table at the beginning of the example.
4. Liability for future policy benefits at the end of the year is calculated as the liability for future policy benefits at the beginning of the year + net premium + interest accretion – death claims.

Method 3: Single equivalent rate

Policy year	Liability for future policy benefits (beginning of year)	Net premiums[1]	Interest accretion[2]	Death claims[3]	Liability for future policy benefits (end of year)[4]
1	0	39,328	527	33,300	6,555
2	6,555	39,196	613	36,348	10,016
3	10,016	39,053	658	39,522	10,205
4	10,205	38,898	658	42,837	6,924
5	6,924	38,729	612	46,265	0

Notes:

1. See 'Net premium' note in Method 1: Spot rate table.
2. Interest accretion for each year is calculated as the (liability for future policy benefits at the beginning of the year + net premium) × single equivalent rate for the year. For example, Year 1 interest accretion is calculated as ($0 + $39,328) × 1.340%, and Year 2 is calculated as ($6,555 + $39,196) × 1.340%.
3. See claims column in the estimated future cash flow table at the beginning of the example.
4. Liability for future policy benefits at the end of the year is calculated as liability for future policy benefits at the beginning of the year + net premium + interest accretion – death claims.

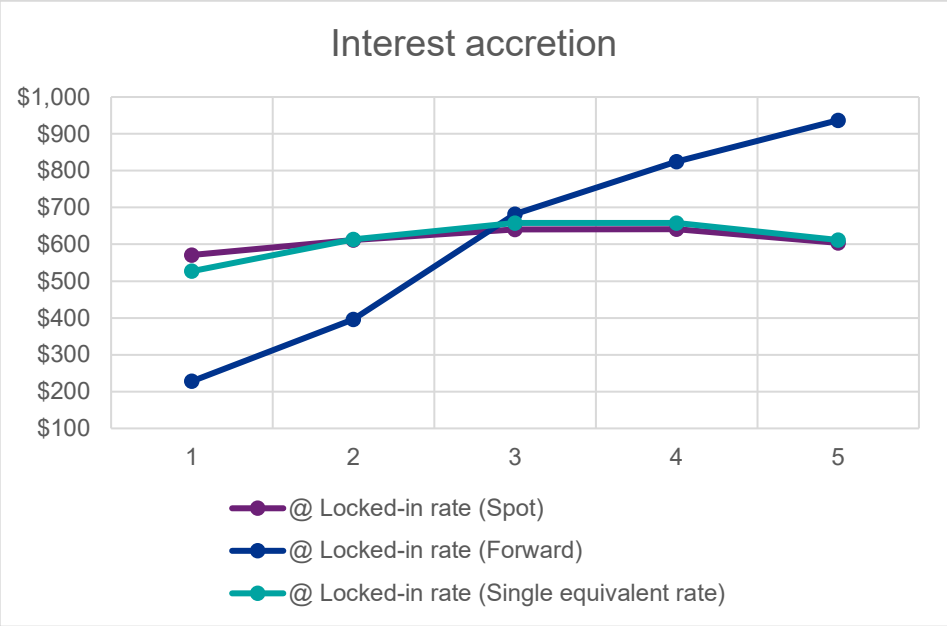
Comparison between the spot rate, forward rate and single equivalent rate method

The following graph shows the interest accretion for each period end during the five-year contract life under the three different discount rate development methods.

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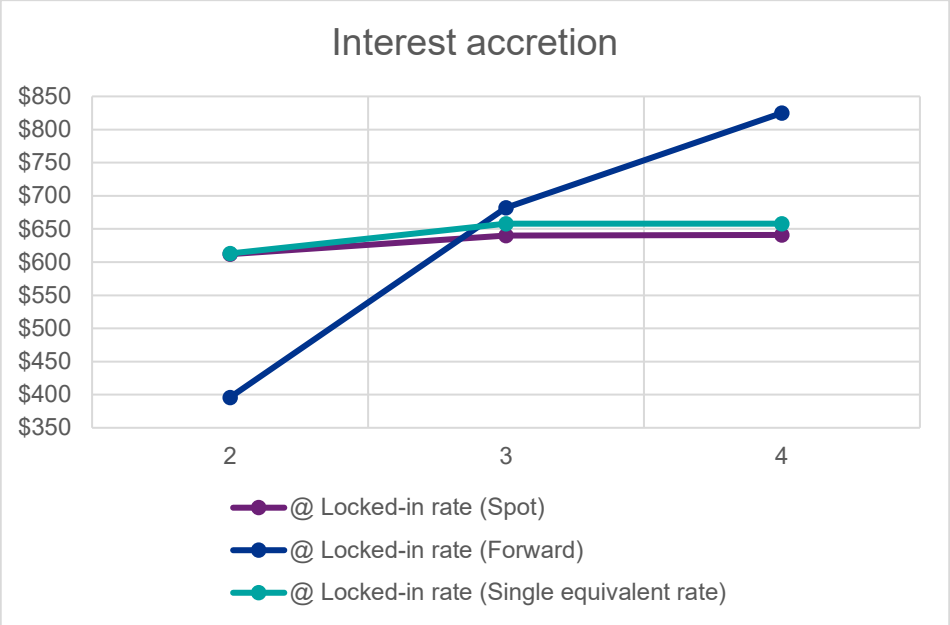
In an economic environment with a typically upward sloping yield curve, the forward rate method generally results in lower interest accretion to the liability for future policy benefits (more net income) in earlier years and higher interest accretion (less net income) in later years when compared to the spot rate and single equivalent rate methods. The spot rate and the single equivalent rate methods generally result in more levelized interest accretion over the life of the contract.

When the yield curve does not follow a smooth, upwardly sloped pattern, forward rates can exhibit fluctuations from period to period, and may become negative for a time, resulting in similar, volatile accretions of interest.

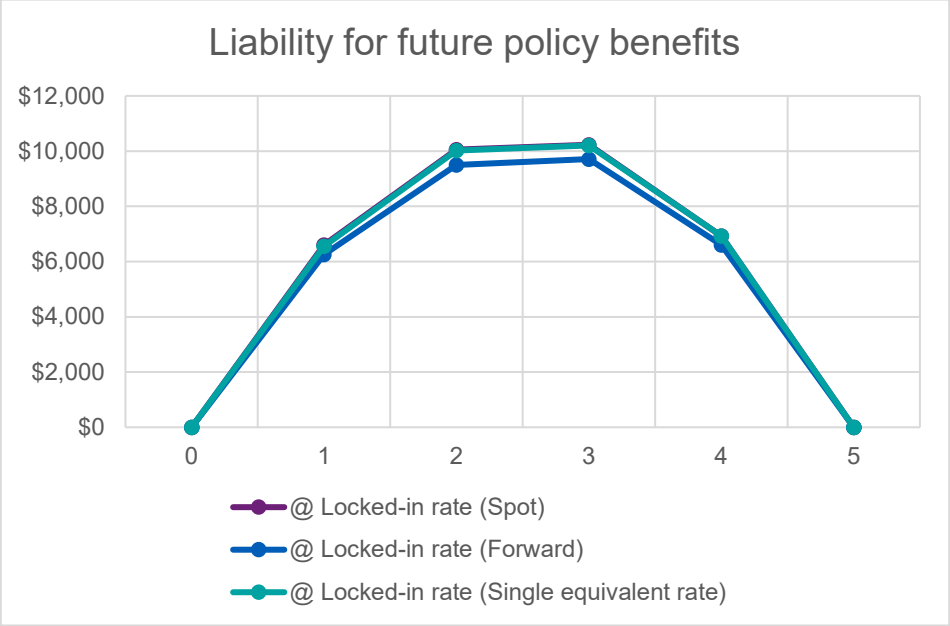


For illustrative purposes, Years 2 to 4 are isolated and highlighted in more detail below.

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The following graph shows the liability for future policy benefits at the end of each year during the five-year contract life under the three different discount rate development methods.



In the graph above, the Spot and single equivalent rate lines appear as a single line. For illustrative purposes, Years 2 to 3 are isolated and highlighted in more detail below.

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Once Life Insurer establishes the interest accretion rate for a contract group, it cannot change the method for determining the interest accretion rate in a subsequent measurement period. For further guidance, see Question 2.4.60.

2.4.20 Update the discount rate

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

35-5…

b. The discount rate assumption referenced in paragraph 944-40-30-9 shall be updated for annual and interim reporting periods, as of the reporting date.

35-6A…

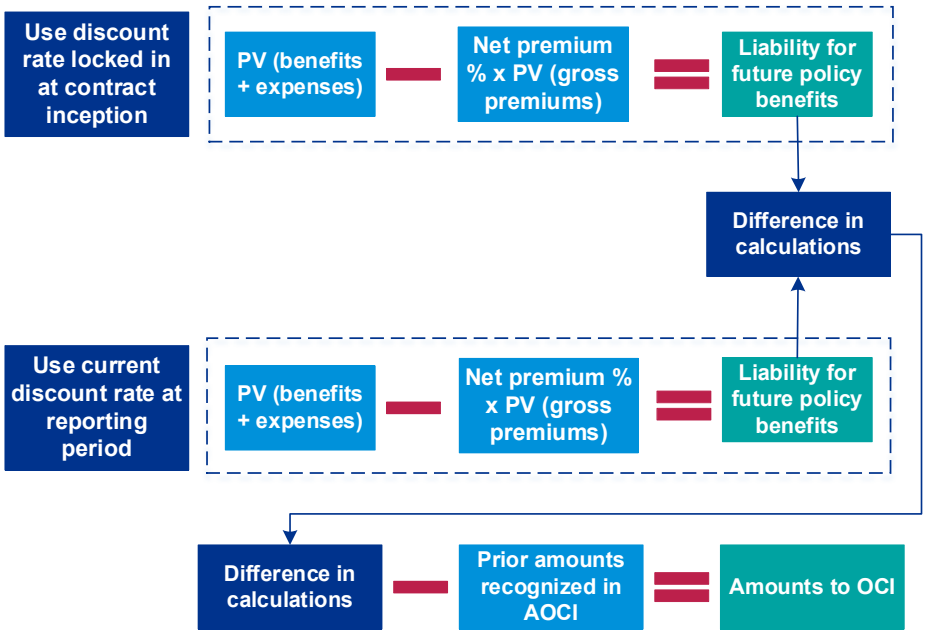
b. Discount rate assumptions. Net premiums shall not be updated for discount rate assumption changes.
   1. The difference between the updated carrying amount of the liability for future policy benefits (that is, the present value of future benefits and expenses less the present value of future net premiums based on updated cash flow assumptions) measured using the updated discount rate assumption and the original discount rate assumption shall be recognized directly to other comprehensive income (that is, on an immediate basis).
   2. The interest accretion rate shall remain the original discount rate used at contract issue date.

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An entity updates the current discount rate used to measure the liability for future policy benefits each annual and interim reporting period. This updated discount rate reflects the current rate for balance sheet measurement. The difference between the liability calculated using the updated current discount rate and the liability calculated using the locked-in discount rate at contract issuance is recognized in OCI. [944-40-35-5(b), 35-6A(b)]

An entity uses the locked-in discount rate at the issuance of the contract for both income statement interest accretion and calculating the net premium ratio. Therefore, it is locked in and not updated. [944-40-35-6A(b)(2)]

The calculation is as follows.



Question 2.4.100 Is the change in the discount rate assumption recognized in net income similar to cash flow assumptions?

Interpretive response: No. An entity recognizes the effect of the change in the current discount rate assumption in OCI each reporting period. It recognizes the remeasurement gain (loss) for changes in cash flow assumptions in net income. [944-40-35-6A(b)(1)]

Recognition is the same for ceded reinsurance contracts. Within OCI, we believe an entity can elect to present the change in the current discount rate assumption for ceded reinsurance contracts on a gross basis (i.e. as a separate line item) or on a net basis with the change in the current discount rate assumption for the underlying direct insurance contracts. [944-40-35-6A(b)(1)]

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Observation Discount rate changes in OCI

The difference in the liability calculated using the current discount rate and the liability calculated using the locked-in discount rate at contract issuance is recognized in OCI. This discount rate difference will often mitigate volatility in OCI from unrealized interest rate changes in available-for-sale debt securities purchased at contract issuance. An entity may think about the interaction of these balances on the financial statements and its investment strategies.

Question 2.4.110 Does an entity update the discount rate used to calculate the liability if it does not update cash flow assumptions?

Interpretive response: Yes. Regardless of whether cash flow assumptions are updated, an entity updates the current discount rate each annual and interim reporting period when calculating the liability for future policy benefits. [944-40-35-5(b)]

Question 2.4.120 Does an entity update the interest accretion rate each reporting period?

Interpretive response: No. An entity uses the original discount rate at contract issuance as the interest accretion rate. This rate is locked in and does not change during the life of the contract group. [944-40-35-6A(b)(2)]

When an entity elects the modified retrospective transition method, the original discount rate (interest accretion rate) is the rate used to calculate the liability for future policy benefits immediately before the transition date (legacy discount rate). For transition guidance for the liability for future policy benefits, see section 7.3.30.

Question 2.4.130 Does an entity update the discount rate to determine the net premium ratio?

Interpretive response: No. An entity uses the original locked-in discount rate at contract issuance as the discount rate for the net premium ratio. This rate does not change during the life of the contract group. [944-40-35-6A(b)]

When an entity elects the modified retrospective transition method, the original discount rate is the rate used to calculate the net premium ratio and the liability for future policy benefits immediately before the transition date (legacy discount rate). For transition guidance for the liability for future policy benefits, see section 7.3.30.

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Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Long-Duration Contracts

35-7B In no event shall the liability for future policy benefits balance be less than zero at the level of aggregation at which reserves are calculated.

Question 2.4.140 Can the liability for future policy benefits go below zero due to a change in the discount rate?

Interpretive response: No. The liability for future policy benefits cannot be less than zero for the level of aggregation an entity uses to calculate the liability. For example, the net premium model may mathematically calculate a remeasured negative liability in an increasing interest rate environment when the present value of future premiums exceeds the present value of future claims. In this situation, the entity follows the guidance in Question 2.3.180. [944-40-35-7B]

This guidance applies to both the locked-in and current discount rate. If changing the discount rate causes the liability for future policy benefits to be less than zero, an entity follows the guidance in Question 2.3.180.

Question 2.4.150 Does an entity consider the uncertainty in the cash flows when determining the discount rate?

Interpretive response: No. The discount rate is an upper-medium grade (low-credit-risk) fixed-income instrument yield that maximizes the use of relevant observable inputs. [944-40-30-9]

An entity considers any potential uncertainty in the timing or amount of cash flows when developing the underlying estimated cash flows. [ASU 2018-12.BC63]

2.5 Other topics

2.5.10 Premium deficiency and loss recognition

Excerpt from ASC 944-60

Long-Duration Contracts

> Instruments

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15-5 The guidance in the Long-Duration Contracts Subsections of this Subtopic applies to long-duration contracts, except for the liability for future policy benefits for traditional and limited-payment contracts subject to the guidance in paragraph 944-40-25-11. Paragraph 944-30-35-63 specifies that the present value of future profits relating to insurance (including traditional and limited-payment) and reinsurance contracts acquired is subject to premium deficiency testing in accordance with the provisions of this Subtopic (see paragraph 944-805-35-3). See the Long-Duration Contracts Subsection of Section 944-20-15 for a discussion of what constitutes a long-duration contract.

General

25-3 Insurance contracts shall be grouped consistent with the entity's manner of acquiring, servicing, and measuring the profitability of its insurance contracts to determine if a premium deficiency exists.

Long-Duration Contracts

25-7 Original policy benefit assumptions for certain long-duration contracts ordinarily continue to be used during the periods in which the **liability for future policy benefits** is accrued under Subtopic 944-40. However, actual experience with respect to investment yields, **mortality**, **morbidity**, terminations, or expenses may indicate that **existing contract** liabilities, together with the present value of future gross premiums, will not be sufficient to do both of the following:

a. Cover the present value of future benefits to be paid to or on behalf of policyholders and settlement costs relating to a block of long-duration contracts
b. Recover unamortized present value of future profits.

Net premiums cannot exceed gross premiums. Also, an entity is required to update net premiums for actual historical experience and any revisions of future cash flow assumptions at least annually. An entity makes more frequent updates when evidence suggests that the cash flow assumptions need to be revised. These changes eliminate the need for premium deficiency testing for traditional and limited-payment contracts. [944-40-35-5 – 35-6A, 944-60-15-5]

Question 2.5.10 Does an entity need to determine loss recognition for traditional and limited-payment contracts?

Interpretive response: Premium deficiency testing of the liability for future policy benefits for traditional and limited-payment contracts is not required. The liability for future policy benefits for traditional and limited-payment contracts is specifically scoped out of the premium deficiency and loss recognition guidance in Subtopic 944-60; this is because the net premium ratio cannot exceed 100%.

Because of this scope exception, an entity is not required to test traditional and limited-payment contracts for: [944-60-15-5]

- loss recognition; or
- profits followed by losses.

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However, any unamortized PVFP (VOBA) associated with traditional and limited-payment contracts continues to be subject to premium deficiency testing. [944-30-35-63, 944-60-15-5]

For guidance on loss contracts, see section 2.3.60. [944-60-15-5]

Question 2.5.20 Does ASU 2018-12 eliminate premium deficiency testing for all long-duration contracts?

Interpretive response: No. An entity may have amortizable intangible assets acquired in a business combination related to insurance contracts – e.g. VOBA or PVFP. ASU 2018-12 requires premium deficiency testing for VOBA and PVFP. For further discussion about premium deficiency testing for purchased insurance contract intangible assets, see section 5.2. [944-60-15-5]

Premium deficiency testing applies to participating life insurance contracts of mutual life insurance entities and contracts that meet the criteria in paragraph 944-20-15-3. For a discussion about participating contracts, see section 2.6.

Universal life-type contracts remain subject to premium deficiency testing. [944-60-15-5]

Question 2.5.30 Does ASU 2018-12 change the guidance for contract grouping for premium deficiency testing?

Interpretive response: No. An entity with contracts subject to premium deficiency testing continues to group them based on its manner of acquiring, servicing and measuring the profitability of the contracts. [944-60-25-3]

An entity considers whether the adoption of ASU 2018-12 changes how it measures the profitability of its contracts. If there is a change, the grouping for premium deficiency testing may also need to change. [944-60-25-3]

Question 2.5.35 What discount rate does an entity use for premium deficiency testing?

Interpretive response: Topic 944 does not prescribe a specific discount rate. Under legacy US GAAP, an entity typically used the expected net investment yield consistent with the measurement of the liability for future policy benefits.

ASU 2018-12 prescribes using an upper-medium grade (low-credit-risk) fixed-income instrument yield to measure the liability for future policy benefits. However, ASU 2018-12 does not require consistency between the discount rate used in premium deficiency testing and the one used to measure the liability for future policy benefits. [944-40-30-9, 944-60-25-7]

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When evaluating the discount rate to use for premium deficiency testing, we believe an entity should consider the rate:

- used under legacy US GAAP and why it was selected; and
- that best represents the future economics of the cash flows – e.g. whether the underlying characteristics support using a rate that is inconsistent with the liability for future policy benefits.

Question 2.5.36 Are unrealized gains and losses included in the PVFP balance used for premium deficiency testing?**

Interpretive response: It depends. We believe that an entity's premium deficiency testing of its unamortized PVFP (VOBA) for traditional and limited-payment contracts should be consistent with the way it measures its PVFP (VOBA) amortization.

Therefore, when an entity incorporates realized gains and losses from securities classified as available-for-sale in its measurement of PVFPP (VOBA) amortization, we believe the entity incorporates the effect of unrealized gains and losses when performing premium deficiency testing of its unamortized PVFP (VOBA) for traditional and limited-payment contracts. [944-30-35-63, 320-10-S99-2]

For a discussion about shadow adjustments, see section 5.3.

Question 2.5.39 Are MRBs included in premium deficiency testing of universal life-type contracts?

Interpretive response: No. Because MRBs are recorded at fair value, they are not subject to premium deficiency testing. However, premium deficiency and loss recognition testing are required for universal life-type contracts. Therefore, premium deficiency testing for universal life-type contracts neither: [944-60-15-5]

- includes expected future cash inflows for fees that are used in the MRBs' fair value measurement, nor
- contemplates the sufficiency of expected future cash inflows to cover the expected future cash outflows for MRBs.

2.5.20 Annuitization benefits

Excerpt from ASC 944-40

Long-Duration Contracts

> Universal Life-Type Contracts and Nontraditional Contract Benefits

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• > Additional Liability

• • > Annuitization Benefits

25-26 This guidance addresses contract features that provide for potential benefits in addition to the account balance that are payable only upon **annuitization**, such as annuity purchase guarantees or **guaranteed minimum income benefits** that are not market risk benefits, and two-tier annuities.

25-27 If the contract feature is not required to be accounted for under paragraph 944-40-25-25C or the provisions of Topic 815 on derivatives and hedging, an additional liability for the contract feature shall be established if the present value of expected annuitization payments at the expected annuitization date exceeds the expected account balance at the expected annuitization date.

30-26 The additional liability required under paragraph 944-40-25-27 shall be measured initially based on the benefit ratio determined by the following numerator and denominator:

a. Numerator. The present value of expected **annuitization** payments to be made and related incremental **claim adjustment expenses**, discounted at an upper-medium grade (low-credit-risk) fixed-income instrument yield applicable to the **payout phase** of the contract, minus the expected accrued account balance at the expected annuitization date (the excess payments). The excess of the present value payments to be made during the payout phase of the contract over the expected accrued account balance at the expected annuitization date shall be discounted at the contract rate.
b. Denominator. The present value of total expected assessments during the **accumulation phase** of the contract, discounted at the contract rate.

Total expected assessments are the aggregate of all charges, including those for administration, mortality, expense, and surrender, regardless of how characterized.

30-27 For contracts whose assets are reported in the general account, the investment margin (that is, the amounts expected to be earned from the investment of policyholder balances less amounts credited to policyholder balances [see paragraph 944-40-25-14]) shall be included with any other assessments for purposes of determining total expected assessments that are referenced in paragraph 944-40-30-26.

30-28 The insurance entity shall calculate the present value of total expected excess payments and total assessments and investment margins, as applicable, based on expected experience. Expected experience shall be based on a range of scenarios that considers the volatility inherent in the assumptions rather than a single set of best estimate assumptions. When determining expected excess payments, the expected annuitization rate is one of the assumptions that needs to be estimated.

30-29 In calculating the additional liability for the additional benefit feature, the contract rate used to compute present value shall be either the rate in effect at the inception of the book of contracts or the latest revised rate applied to the remaining benefit period. The approach selected to compute the present value of revised estimates shall be applied consistently in subsequent revisions to computations of the benefit ratio.

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35-12 The insurance entity shall regularly evaluate estimates used and adjust the additional liability balance recognized under paragraph 944-40-25-27 with a related charge or credit to benefit expense (see paragraph 944-40-45-2), if actual experience or other evidence suggests that earlier assumptions should be revised.

35-15 The cumulative excess payments determined at annuitization in paragraph 944-40-35-14(c) is the amount that shall be deducted at the actual date of annuitization. That amount shall be calculated as the present value of expected annuity payments and related **claim adjustment expenses** discounted at an upper-medium grade (low-credit-risk) fixed-income instrument yield minus the accrued account balance at the actual annuitization date.

An entity assesses whether to recognize an additional liability for contract features that provide annuitization benefits in excess of the account balance and are not MRBs or embedded derivatives. A liability is recognized when the present value of expected annuitization payments during the payout phase exceeds the expected account balance at the annuitization date. For guidance on the evaluation of the contract feature, see Question 3.3.40. [944-40-25-27]

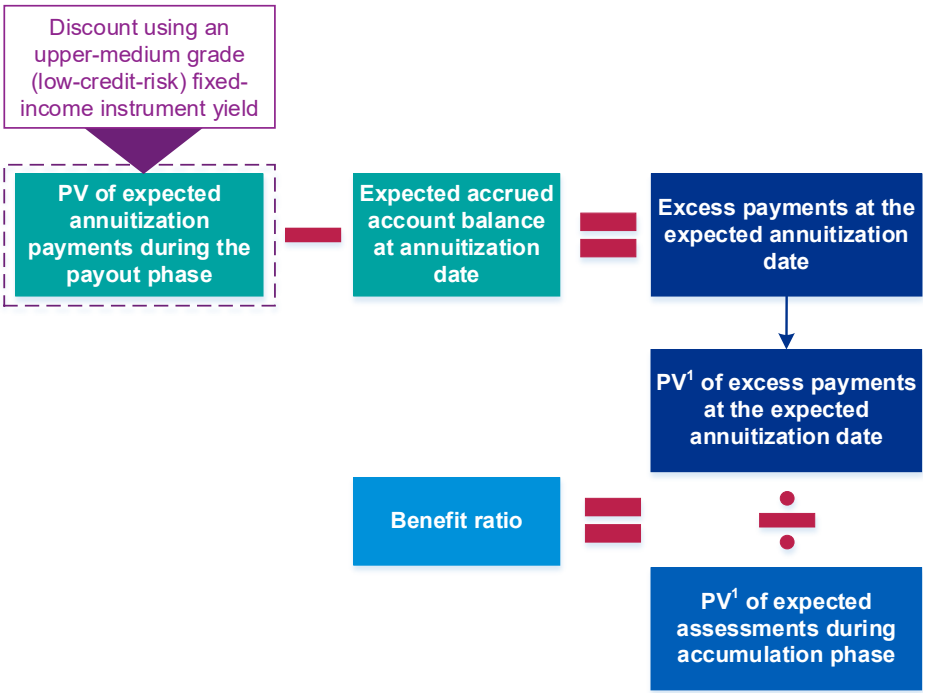
ASU 2018-12 requires an entity to use an upper-medium grade (low-credit-risk) fixed-income instrument yield to discount the expected annuitization payments during the payout phase. Legacy US GAAP required discounting using estimated net investment yields expected to be earned during the payout phase. [944-40-30-26]

See section 2.4.10 for guidance on determining an upper-medium grade (low-credit-risk) fixed-income instrument yield.

Question 2.5.40 How does an entity calculate the additional liability for annuitization benefits?

Interpretive response: An entity calculates the additional liability using a benefit ratio. [944-40-30-26]

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Note:

1. Discount using the contract rate (see Question 2.5.80).

Question 2.5.50 When does an entity recognize an additional liability for annuitization benefits?

Interpretive response: An entity first evaluates whether the contract feature that provides potential annuitization benefits in addition to the account balance is an MRB or an embedded derivative. For guidance on this analysis, see Question 3.3.40.

If the contract feature is not an MRB or an embedded derivative, an additional liability is recognized when the present value of expected annuitization payments during the payout phase is greater than the expected accrued account balance at the annuitization date. [944-40-25-27]

Question 2.5.60 Does ASU 2018-12 change the benefit ratio formula used to calculate the additional liability for annuitization benefits?

Interpretive response: No. ASU 2018-12 does not change the benefit ratio formula, but does change inputs to the formula (see Question 2.5.70). An entity continues to use the benefit ratio to calculate additional liabilities for annuitization benefits that are not MRBs or embedded derivatives. For further guidance about the benefit ratio, see Question 2.5.40. [944-40-30-26]

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Question 2.5.70 Does ASU 2018-12 change the discount rate used to calculate the present value of annuity payments?

Interpretive response: Yes. An entity uses an upper-medium grade (low-credit-risk) fixed-income instrument yield as compared to an estimated net investment yield used in legacy US GAAP. [944-40-30-26(a)]

ASU 2018-12 also requires an entity to discount the excess payments and expected assessments in the benefit ratio using the contract rate. [944-40-30-26]

Legacy US GAAP did not specify that the contract rate had to be used. However, we do not believe this will be a change for most entities because they typically used the contract rate.

For further guidance about the contract rate, see Question 2.5.80.

Question 2.5.80 What is the contract rate?

Interpretive response: The contract rate is the rate used to credit interest to the policyholder account balance. An entity calculates the additional liability using the rate in effect at issuance of the book of contracts or the latest revised rate applied to the remaining benefit period. Once selected, this rate is consistently applied when calculating the additional liability. [944-40 Glossary, 944-40-30-26, 30-29]

To change the rate, we believe an entity should evaluate whether the new method produces a better estimate and follow the guidance in Topic 250 for changing an accounting estimate. [250-10-45-17 – 45-20]

For further guidance, see section 3.4 of KPMG Handbook, Accounting changes and error corrections.

Question 2.5.90 Does an entity recognize changes in the discount rate for the benefit ratio in OCI?

Interpretive response: No. ASU 2018-12 changes the rate to calculate the present value of expected annuity payments to an upper-medium grade (low-credit-risk) fixed-income instrument yield without changing the recognition of the liability remeasurement under legacy US GAAP. [944-40-30-26, 35-12]

Under ASU 2018-12, the effect of the change in discount rates used to update the benefit ratio and remeasure the liability is recognized in the liability remeasurement gain (loss) in benefits expense. Changes in the discount rate used to determine the benefit ratio are not recognized in OCI. [944-40-35-12]

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2.5.30 Death or other insurance benefits

Excerpt from ASC 944-40

Long-Duration Contracts

> Universal Life-Type Contracts and Nontraditional Contract Benefits

• > Additional Liability

• • > Death or Other Insurance Benefits

25-27A If the contract feature is not required to be accounted for under paragraph 944-40-25-25C or the provisions of Topic 815 on derivatives and hedging and if the amounts assessed against the contract holder each period for the insurance benefit feature of an insurance contract are assessed in a manner that is expected to result in profits in earlier years and losses in subsequent years from the insurance benefit function, a liability for death or other insurance benefits shall be recognized in addition to the account balance.

30-20 The amount of the additional liability recognized under paragraph 944-40-25-27A shall be determined based on the ratio (benefit ratio) of the following:

a. Numerator. The present value of total expected excess payments over the life of the contract, discounted at the **contract rate**.
b. Denominator. The present value of total expected assessments over the life of the contract, discounted at the contract rate.

Total expected assessments are the aggregate of all charges, including those for administration, mortality, expense, and surrender, regardless of how characterized. The contract rate used to compute present value shall be either the rate in effect at the inception of the book of contracts or the latest revised rate applied to the remaining benefit period. The approach selected to compute the present value of revised estimates shall be applied consistently in subsequent revisions to computations of the benefit ratio.

30-22 For contracts in which the assets are reported in the **general account**, the investment margin (that is, the amounts expected to be earned from the investment of policyholder balances less amounts credited to policyholder balances [see paragraph 944-40-25-14]) shall be included with any other assessments for purposes of determining total expected assessments that are referenced in paragraph 944-40-30-20.

30-22A An increase during a period in an unearned revenue liability (that is, deferral of revenue) established in paragraphs 944-605-25-6 through 25-7 shall be excluded from the amounts assessed against the contract holder's account balance for that period and a decrease in (that is, amortization of) an unearned revenue liability in accordance with paragraph 944-605-35-2 during a period shall be included with the assessments for that period.

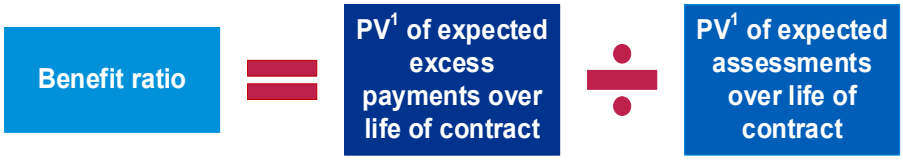
For universal life-type contracts and nontraditional contract benefits, an entity recognizes an additional liability for death or other insurance benefits when the amounts assessed against the contract holder result in profits followed by losses. [944-40-25-27A]

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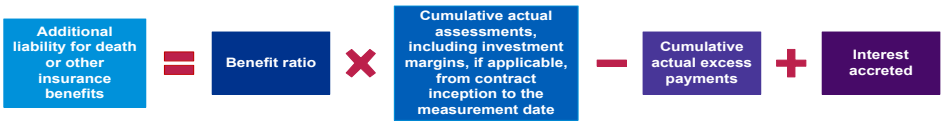
ASU 2018-12 does not change legacy US GAAP for calculating the benefit ratio, except for stating that the discount rate is the contract rate. [944-40-30-20]

Question 2.5.100 How does an entity calculate the additional liability for death or other insurance benefits?

Interpretive response: The additional liability for death or other insurance benefits is measured using a benefit ratio. [944-40-30-20]



The benefit ratio is then used to measure the additional liability for death or other insurance benefits.



Note:

1. Discount using the contract rate (see Question 2.5.80).

Question 2.5.110 When does an entity recognize an additional liability for death or other insurance benefits?

Interpretive response: For universal life-type contracts and nontraditional contract benefits, an entity first evaluates whether the contract feature that provides benefits in addition to the account balance is an MRB or an embedded derivative. For guidance on this analysis, see Question 3.3.40. [944-40-25-25B]

If the contract feature is not an MRB or an embedded derivative, an entity recognizes a liability for death or other insurance benefits when assessments against the contract holder result in profits in earlier years and losses in subsequent years. [944-40-25-27A]

Question 2.5.120 Does ASU 2018-12 change the benefit ratio formula used to calculate the additional liability for death or other insurance benefits?

Interpretive response: No. ASU 2018-12 does not change the benefit ratio formula, but does clarify the discount rate used in the formula (see Question 2.5.130). An entity continues to use the benefit ratio to calculate additional liabilities for death or other insurance benefits. [944-40-30-20]

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Question 2.5.130 Does ASU 2018-12 change the discount rate an entity uses to calculate the present value of excess payments and assessments?

Interpretive response: ASU 2018-12 clarifies that an entity discounts the excess payments and expected assessments in the benefit ratio using the contract rate. [944-40-30-20]

For additional guidance on the contract rate, see Question 2.5.80.

Question 2.5.140 Does an entity include investment margin in expected assessments in the benefit ratio?

Interpretive response: Yes. For contracts with assets reported in the general account, an entity includes the investment margin with other assessments to calculate total expected assessments in the benefit ratio. ASU 2018-12 also clarifies that the investment margin is:



Investment margin is not the interest earned on the net liability. [944-40-30-22]

Because this clarification does not change legacy US GAAP, an entity should ensure consistency between historical and projected periods and follow the guidance in Topic 250 if it modifies its calculation. [250-10-45-2]

For transition considerations, see Question 7.3.95.

For further guidance, see KPMG Handbook, Accounting changes and error corrections.

Question 2.5.150 Do assessments include amortization of unearned revenue reserves?

Interpretive response: Yes. Amortization of unearned revenue reserves during the period is included with the assessments for the period. An entity does not include the deferral of revenue with the amounts assessed against the account balance for the period. [944-40-30-22A]

For further guidance on the amortization of unearned revenue reserves, see Question 5.5.10.

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2.5.40 Claim liabilities

Question 2.5.160 How are claims liabilities measured?

Interpretive response: Under ASU 2018-12, an entity calculates a single liability for future policy benefits that comprises all expected cash flows under the contract, including those for claims incurred.

For guidance on the cash flows included in the liability for future policy benefits calculation, see Question 2.3.85. For guidance on presentation, see Question 2.7.20.

2.5.50 Ceded reinsurance

Question 2.5.200 How is the reinsurance recoverable recognized?

Interpretive response: An entity estimates reinsurance recoverables using assumptions that are consistent with those used to estimate the liabilities of the underlying reinsured contracts. This treatment under ASU 2018-12 is consistent with legacy US GAAP. [944-40-25-34]

We believe the net premium insurance accounting model is appropriate to estimate the ceded reinsurance recoverable asset. The FASB observed that this model aggregates total cash inflows and outflows over a contract's entire life to calculate a net premium ratio that is used to derive a constant profit margin. This results in GAAP profits emerging differently from cash inflows and outflows. [ASU 2018-12.BC50]

Under the net premium insurance model, we believe the reinsurance recoverable asset is estimated using contract groups that are consistent with the contract groups the entity uses to calculate the liability for future policy benefits of the underlying contracts. The discount rate is an upper-medium grade (low-credit-risk) fixed-income instrument yield. [944-40-30-7, 30-9, 35-5(b), 35-6A(b)]

For guidance on the net premium insurance accounting model, see section 2.2. For guidance on the locked-in discount rate for reinsurance contracts, see Question 2.5.210.

Question 2.5.210 How is the interest accretion rate used to estimate the reinsurance recoverable determined?

Interpretive response: An entity estimates reinsurance recoverables using assumptions that are consistent with those used to estimate the liabilities of the underlying reinsured contracts. This treatment under ASU 2018-12 is

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consistent with legacy US GAAP. However, under ASU 2018-12, the discount rate is an upper-medium grade (low-credit-risk) fixed-income instrument yield [944-40-25-34, 30-7, 30-9, 35-5(b), 35-6A(b)]

Prospective reinsurance agreement

An entity may enter into a reinsurance contract to cede underlying insurance contracts issued contemporaneously with or subsequent to the reinsurance contract's effective date – i.e. prospective reinsurance agreement. For this type of agreement, we believe a reinsurance recoverable contract group's interest accretion rate is established using the contract issue date of each of the underlying reinsured contracts. [944-40-30-7, 30-9, 35-5(b), 35-6A(b)]

In force reinsurance agreement

Alternatively, an entity may enter into a reinsurance contract to cede previously existing traditional and limited-payment long-duration insurance contracts – i.e. in force reinsurance agreement. For this type of agreement, we believe a reinsurance recoverable contract group's interest accretion rate is established using the issue date of the reinsurance contract. Generally, this will result in differences in measurement of the reinsurance recoverable and the liability for future policy benefits of the underlying reinsured contracts. [944-40-30-7, 30-9, 35-5(b), 35-6A(b)]

For guidance on contract groups for reinsurance contracts, see Question 2.5.200.

Question 2.5.220 How is the reinsurance recoverable affected by the requirement that the revised net premium ratio for direct insurance contracts not exceed 100%?

Interpretive response: For traditional and limited-payment long-duration contracts, the revised ratio of net premiums to gross premiums cannot exceed 100%. If the net premium ratio exceeds 100%, an entity recognizes an immediate charge in net income to reflect the amount needed for net premiums to equal gross premiums. [944-40-25-34, 30-7A, 35-6A(a), 35-7A]

We believe the net premium insurance accounting model is appropriate to estimate the ceded reinsurance recoverable asset. The ceded reinsurance recoverables are estimated using assumptions that are consistent with those used to estimate the liabilities of the underlying traditional and limited-payment long-duration contracts reinsured. For further discussion, see Question 2.5.200. [944-40-25-34]

For initial measurement, Topic 944 states that an immediate gain is not recognized at the inception of a reinsurance contract unless it is a legal replacement that extinguishes the ceding entity's liability to the contract holder. However, for subsequent measurement, Topic 944 does not indicate how to apply the requirement that the revised net premium ratio for direct insurance contracts not exceed 100% to reinsurance ceded. [944-40-25-33, 36-6A(a)]

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For subsequent measurement, in the absence of guidance in Topic 944, we believe an entity may satisfy this requirement by recognizing an immediate gain on the reinsurance ceded contract to the extent it has recognized an immediate charge in income in the current reporting period on the underlying direct insured contracts to reflect net premiums equal to gross premiums. As such, for subsequent measurement, we believe an entity does not recognize a gain on the reinsurance ceded contract that is in excess of the current reporting period loss recognized on the underlying direct insured contracts. [944-40-25-34]

The financial statement results will depend on the following circumstances.

Type of reinsurance contract	Effect on financial results
Coinsurance of the entire contract group with all terms matching the underlying direct insured contracts (including measurement groupings)	Generally, for subsequent measurement, this will result in consistency in the financial statement results of the underlying direct insured contracts and the reinsurance contract.
Nonproportional – e.g. yearly renewable term reinsurance	Generally, will result in measurement differences between the ceded reinsurance recoverable and the liability for future policy benefits for the underlying direct insured contracts, which may result in inconsistency in how they are affected by the requirement that the net premium ratio not exceed 100%.

For additional discussion about the revised net premium ratio for direct insurance contracts, see section 2.3.50. For additional discussion about loss contracts, see section 2.3.60.

Question 2.5.230 How is the reinsurance recoverable affected by the requirement that the liability is floored at zero for direct insurance contracts?

Interpretive response: For traditional and limited-payment long-duration contracts, the liability cannot be less than zero at the contract group level used to calculate the liability. If the liability for future policy benefits at the contract group level is less than zero, an entity recognizes an immediate charge in net income to reflect the amount needed to recognize the liability at zero – i.e. to floor the reserve. [944-40-30-7A, 35-7B]

An entity estimates ceded reinsurance recoverables using assumptions that are consistent with those used to estimate the liabilities of the underlying traditional and limited-payment long-duration contracts reinsured. For further discussion, see Question 2.5.200. [944-40-25-34]

For initial measurement, Topic 944 provides guidance that an entity should not recognize an immediate gain at the inception of a reinsurance contract unless it is a legal replacement that extinguishes the ceding entity's liability to the contract holder. However, for subsequent measurement, Topic 944 does not provide guidance on the application to reinsurance ceded of the requirement that the liability for future policy benefits should not be less than zero.

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For subsequent measurement, we believe an entity may recognize an immediate gain on the reinsurance ceded contract to the extent it has recognized an immediate charge to income in the current reporting period to floor the liability for future policy benefits for the underlying direct insured contracts. As such, for subsequent measurement, we do not believe an entity recognizes a gain on the reinsurance ceded contract that is in excess of the current reporting period loss recognized on the underlying direct insured contracts. [944-40-25-34]

The financial statement results will depend on the following circumstances. [944-40-25-34]

Type of reinsurance contract	Effect on financial results
Coinsurance of the entire contract group with all terms matching the underlying direct insured contracts (including measurement groupings)	Generally, for subsequent measurement, this will result in consistency in the financial statement results of the underlying direct insured contracts and the reinsurance contract, with the reinsurance recoverable asset recognized at zero.
Nonproportional – e.g. noncancellable yearly renewable term reinsurance or excess of loss reinsurance	Generally, will result in measurement differences between the ceded reinsurance recoverable and the liability for future policy benefits for the underlying direct insured contracts, which may result in a ceded reinsurance recoverable asset less than zero – i.e. the recognition of a reinsurance liability. This may result when reinsurance cash inflows (premiums) are lower or where reinsurance cash outflows (benefits) are higher at the beginning of a contract and the cost of reinsurance is recognized on a constant-margin basis.

For additional discussion about loss contracts, see section 2.3.60.

Question 2.5.240 Do the cash flows used to measure the liability for future policy benefits change when contracts are ceded?

Interpretive response: No. The measurement of the liability for future policy benefits for the direct contracts is separate from the measurement of the reinsurance recoverable. When an entity enters into a reinsurance contract to cede long-duration contracts, we believe the net premium model used to estimate the liability for future policy benefits for the direct contracts continues to include all of the cash flows for those long-duration contracts. [944-40-30-7]

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Separately, the entity estimates its reinsurance recoverables using assumptions that are consistent with those used to estimate the liabilities of the underlying reinsured contracts. [944-40-25-34]

For guidance on estimating the reinsurance recoverable, see Question 2.5.200.

2.5.60 Assumed reinsurance

Question 2.5.300 Are assumed traditional and limited-payment long-duration reinsurance contracts subject to the guidance for direct insurance contracts?

Interpretive response: Yes. An entity assuming traditional and limited-payment long-duration contracts accounts for deferred acquisition costs, policyholder liabilities and other related balances using the same accounting guidance as direct insurers. ASU 2018-12 does not contain guidance specific to assumed traditional and limited-payment long-duration contracts. Therefore, an entity assuming such contracts follows the guidance in ASU 2018-12 for direct insurance contracts. [FASB 113, BC47]

Question 2.5.310 What is the unit of account for assumed traditional and limited-payment long-duration reinsurance contracts?

Interpretive response: It depends. Topic 944 does not provide guidance on the unit of account for assumed traditional and limited-payment long-duration reinsurance contracts. However, the contract group can be no greater than an annual period. For these contracts, an assuming entity uses judgment to determine the unit of account used for recognition and measurement of the liability for future policy benefits (assumed). [944-40-30-7]

Prospective reinsurance agreements

Some contracts reinsure underlying insurance contracts issued contemporaneously with or subsequent to the reinsurance contract's effective date – i.e. prospective reinsurance agreement. An assuming entity may recognize and measure the prospective reinsurance contract as the underlying direct contracts are issued – i.e. the look-through approach. Using this approach, an assuming entity 'looks through' the reinsurance contract to the underlying direct contracts written by the ceding entity when determining the unit of account. An assuming entity uses contract groups to calculate the liability for future policy benefits (assumed) using the same guidance for contract grouping as the ceding entity.

Additionally, to calculate the liability for future policy benefits (assumed), an assuming entity cannot group contracts together from different original contract issue years. Therefore, an assuming entity's contract groups are based on the

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contract issue year of the underlying direct contract and not the date of the reinsurance contract. For reinsurance contracts that cover underlying business written over multiple annual periods, this will result in the assuming entity using multiple contract groups to calculate the liability for future policy benefits (assumed). Further, the discount rate used is specific to the individual contract grouping and not the reinsurance contract. [944-40-30-7]

If an assuming entity uses an approach other than the look-through approach to measure its liability for future policy benefits (assumed) for contracts issued contemporaneously with or subsequent to the reinsurance contract's effective date, judgment is needed to apply the relevant measurement requirements of Topic 944.

In force reinsurance agreements

Alternatively, an entity may enter into a reinsurance contract to assume previously existing traditional and limited-payment long-duration insurance contracts – i.e. an in force reinsurance agreement. In this situation, the underlying direct contracts will have the same issue year based on the date of the reinsurance contract. This may result in the assuming entity's contract group including contracts that were issued by the ceding entity in different issue years. [944-40-30-7]

Prospective and in force reinsurance agreements

Additionally, a single reinsurance contract may include different types of underlying insurance contracts – e.g. whole life, long-term care and limited-payment contracts. Similar to the direct writer, an assuming entity considers whether to disaggregate the reinsurance contract using the same contract grouping guidance as the ceding entity. This may result in an assuming entity grouping contracts in a single reinsurance agreement into different contract groups with the same issue year. [944-40-30-7]

For additional discussion about grouping contracts to calculate the liability for future policy benefits, see section 2.2.10.

2.6 Participating contracts

Excerpt from ASC 944-20

General

> Other Considerations

• > Certain Long-Duration Participating Life Insurance Contracts

15-3 Certain guidance in the Long-Duration Subsections in this Subtopic (and other Subtopics within the Financial Services—Insurance Topic) applies only to certain long-duration participating life insurance contracts of mutual life insurance entities and certain stock life insurance entities. For purposes of that guidance:

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a. Mutual life insurance entities include assessment entities, fraternal benefit societies, and stock life insurance subsidiaries of mutual life insurance entities.
b. Participating life insurance contracts denote those that have both of the following characteristics:
    1. They are long-duration participating contracts that are expected to pay **dividends to policyholders** based on actual experience of the insurance entity.
    2. **Annual policyholder dividends** are paid in a manner that both:
        a. Identifies divisible surplus
        b. Distributes that surplus in approximately the same proportion as the contracts are considered to have contributed to divisible surplus (commonly referred to in actuarial literature as the contribution principle).

15-4 Paragraph 944-20-15-11 states that stock life insurance entities with participating life insurance contracts that meet certain conditions are permitted to account for those contracts in accordance with the Long-Duration Contracts Subsections of this Subtopic. That paragraph explains that the same accounting policy shall be applied consistently to all those participating life insurance contracts.

Long-Duration Contracts

> Instruments

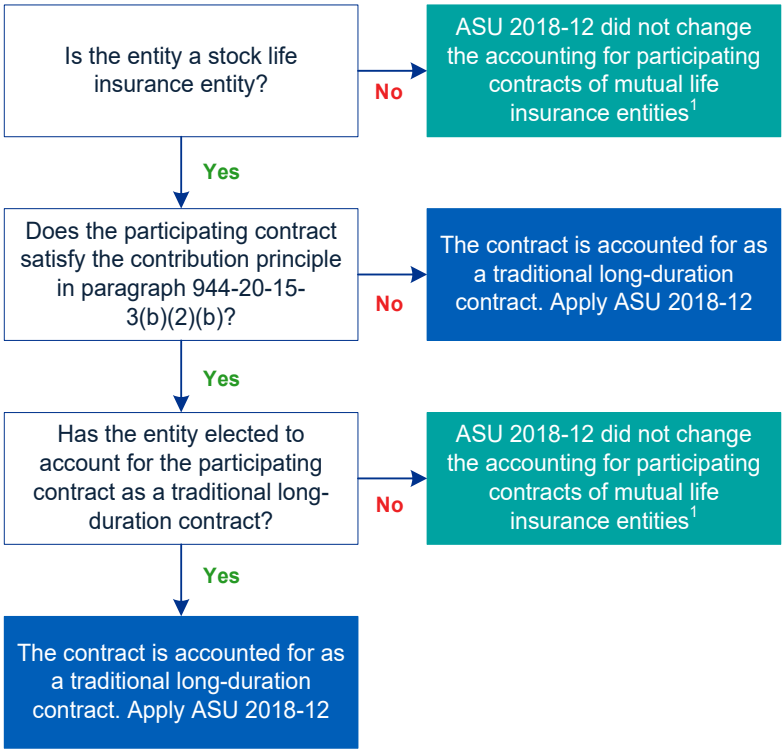
15-11 The guidance in the Long-Duration Contracts Subsections of this Subtopic applies, in part, to the following classes of long-duration contracts issued:

a. Universal life-type contracts, that is, long-duration insurance contracts with terms that are not fixed and guaranteed
b. **Limited-payment contracts**, including limited-payment participating and limited-payment nonguaranteed-premium contracts that are not, in substance, universal life-type contracts
c. Except as noted in paragraph 944-20-15-3, participating life insurance contracts
d. **Whole-life contracts**, that is, insurance contracts that may be kept in force for a person's entire life by paying one or more premiums
e. **Term life insurance** contracts, that is, insurance contracts that provide a benefit if the insured dies within the period specified in the contract.

Stock life insurance entities with participating life insurance contracts described in (c) are permitted to account for those contracts in accordance with the Long-Duration Contracts Subsections of this Subtopic. The same accounting policy shall be applied consistently to all those participating life insurance contracts.

An entity uses the following steps to determine whether its accounting for participating contracts changes when adopting ASU 2018-12: [944-20-15-3 – 15-4, 15-11]

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Note:

1. Except for terminal dividends (see Question 2.6.20).

An entity that elects to account for its participating contracts as traditional long-duration contracts follows the guidance in this chapter to calculate the liability for future policy benefits for its participating contracts.

Question 2.6.10 Can an entity change its accounting policy election for participating contracts?

Interpretive response: Yes, if the change is preferable. An entity that elected to account for its participating contracts as traditional long-duration contracts should consistently apply its accounting policy. [944-20-15-11]

We believe a change to this accounting policy represents a change in accounting principle under Topic 250, and an entity should not change the accounting policy unless it is preferable. [250-10-45-2]

For further guidance, see section 3.3 of KPMG Handbook, Accounting changes and error corrections.

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Excerpt from ASC 944-40

Long-Duration Contracts

> Certain Participating Life Insurance Contracts

35-22 Terminal dividends accrued under paragraph 944-40-25-30 shall be recognized as an expense over the life of a book of participating life insurance contracts, at a constant rate based on the present value of the base used for the amortization of deferred **acquisition costs**.

35-23 The present value of the amortization base shall be computed using the expected **investment yield** (net of related investment expenses). Accordingly, interest shall accrue on the balance of terminal dividends.

Question 2.6.20 How are terminal dividends accrued?

Interpretive response: An entity accrues terminal dividends at a constant rate based on the present value of the base used for DAC amortization. Interest is accrued on the balance of terminal dividends. [944-40-35-22 – 35-23]

Under legacy US GAAP, terminal dividends were accrued over the life of the contract in proportion to the present value of estimated gross margins.

2.7 Presentation

Excerpt from ASC 944-40

Long-Duration Contracts

> Universal Life-Type Contracts and Nontraditional Contract Benefits

• > Death or Other Insurance Benefits

45-1 The change in the estimate of the additional liability for death or other insurance benefits recognized under the guidance in paragraph 944-40-25-27A as of the beginning of the current period (that is, the liability remeasurement gain or loss as a result of applying the revised benefit ratio) shall be presented as a separate component of total benefit expense in the statement of operations, either parenthetically or as a separate line item. The liability remeasurement gain or loss may be reported together with the liability remeasurement gain or loss related to **annuitization** benefits and traditional and **limited-payment contracts**.

• > Annuitization Benefits

45-2 The change in the estimate of the additional liability for annuitization benefits recognized under the guidance in paragraph 944-40-25-27 as of the beginning of the current period (that is, the liability remeasurement gain or loss as a result of applying the revised benefit ratio) shall be presented as a separate component of total benefit expense in the statement of operations,

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either parenthetically or as a separate line item. The liability remeasurement gain or loss may be reported together with the liability remeasurement gain or loss related to death or other insurance benefits and traditional and limited-payment contracts.

> Traditional and Limited-Payment Contracts

45-4 The current-period change in estimate of the liability for future policy benefits (that is, the liability remeasurement gain or loss) calculated under paragraph 944-40-35-6A(a)(1) shall be presented as a separate component of total benefit expense in the statement of operations, either parenthetically or as a separate line item. For limited-payment contracts, the corresponding current-period change in estimate of the deferred profit liability (that is, the liability remeasurement gain or loss) calculated under paragraph 944-605-35-1C shall be presented separately in net income, either parenthetically or as a separate line item. The liability remeasurement gain or loss for traditional and limited-payment contracts may be reported together with the liability remeasurement gain or loss related to annuitization benefits and death or other insurance benefits.

The remeasurement gain (loss) calculated for the change in the liability is recognized as a separate component of total benefit expense. The gain (loss) may be presented parenthetically or as a separate financial statement line item in the income statement. [944-40-45-1 – 45-2, 45-4]

Question 2.7.10 Can an entity combine the remeasurement gain (loss) with other items?#

Interpretive response: Yes. An entity may report the remeasurement gain (loss) for traditional and limited-payment contracts together with the remeasurement gain (loss) for annuitization benefits and death or other insurance benefits. An entity considers whether combined presentation allows users the information to understand the amount, timing and uncertainty in cash flows. However, remeasurement gains (losses) are not combined with other items (i.e. non-remeasurement gains (losses)), unless the amount of the remeasurement gains (losses) is presented parenthetically. [944-40-45-1 – 45-2, 45-4]

Question 2.7.20 Can an entity present the liability for future policy benefits in two financial statement captions?

Interpretive response: Yes. Under ASU 2018-12, an entity calculates a single liability for future policy benefits. An entity may elect to separately present the components of the liability on the balance sheet similar to legacy US GAAP – i.e. a liability for: [944-40-25-8, 25-11, 30-7, 35-6A]

- future policy benefits (claims not yet incurred); and
- unpaid claim and claim adjustment expenses (incurred claims not yet paid).

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However, this is a presentation election and does not change the measurement of the contract's single liability obligation. Therefore, the separate presentation election should not result in a different:

- total liability at the reporting date;
- income, expense or OCI amounts for the reporting period; or
- discount rate for the separately presented components.

For guidance on cash flows considered in the single liability calculation, see Question 2.3.85.

2.8 Transition

An entity applies the requirements of ASU 2018-12 for the liability for future policy benefits to contracts in force at the transition date. This is referred to as a modified retrospective adoption method. [944-40-65-2(c) – 65-2(e)]

An entity may also elect to apply ASU 2018-12 using a retrospective adoption method for all periods presented if certain criteria are met. [944-40-65-2(c) – 65-2(e)]

For additional guidance on both transition methods, see chapter 7.

2.9 Liability for future policy benefits examples

ASU 2018-12 includes examples provided by the FASB that illustrate how an entity updates its assumptions to measure the liability for future policy benefits.

Excerpt from ASC 944-40

Long-Duration Contracts

> Illustrations

• > Example 6: Updating of Assumptions Used in the Measurement of the Liability for Future Policy Benefits

55-29H This Example illustrates an approach to updating assumptions used to measure the liability for future policy benefits related to traditional life insurance contracts.

55-29I This Example assumes the following for the contracts discussed:

a. At contract inception:
   1. The insurance entity issues 1,000 guaranteed-renewable 20-year term life insurance contracts that are grouped into a single cohort for purposes of measuring the liability for future policy benefits.
   2. Face amount per contract: $200,000.
   3. Annual premium per contract: $500.
   4. Discount rate: 0 percent.
   5. **Lapse rate**: 5 percent for all years.
   6. Mortality rate: 0.1 percent in Year 1, increasing linearly to 0.29 percent in Year 20.

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7. For ease of illustration, no expenses are assumed, benefit payments and premium receipts occur at the end of the year, and annual periods are presented.

b. During Year 6: The insurance entity experiences unfavorable mortality that is 20 percent higher than expected. The insurance entity determines that it does not need to change its future mortality or lapse assumptions.

c. During Year 9: After experiencing continued unfavorable mortality (20 percent higher than expected in Years 7 through 9), the insurance entity increases its mortality assumption by 20 percent for Years 10 through 20.

d. During Year 10: The current upper-medium grade (low-credit-risk) fixed-income instrument yield increases from 0 percent to 2 percent. The insurance entity does not change its future mortality or lapse assumptions.

55-29J This Example illustrates computations involved in the following:

a. Net premiums
b. Liability remeasurement adjustments.

55-29K The computation of the original net premium ratio at the issue date of the portfolio of contracts follows.

	Original Cash Flow Estimate	
Year	**Benefits**	**Gross Premiums**
1	$ 200.0	$ 500.0
2	208.8	474.5
3	216.1	450.3
4	222.2	427.3
5	227.0	405.4
6	230.7	384.6
7	233.5	364.8
8	235.3	346.0
9	236.3	328.1
10	236.5	311.2
11	236.0	295.1
12	235.0	279.7
13	233.4	265.2
14	231.3	251.4
15	228.7	238.3
16	225.8	225.8
17	222.5	214.0
18	219.0	202.8
19	215.1	192.1
20	211.1	182.0
Total	$ 4,504.4	$ 6,338.4
Present value [a]	$ 4,504.4	$ 6,338.4
Net premium ratio [b]	71.1%	

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(a) 0% discount rate.

(b) Present value of benefits/present value of gross premiums (for Years 1–20).

55-29L The computation of the liability for future policy benefits at the end of Year 1 follows.

Liability for Future Policy Benefits (End of Year 1)

Year	Benefits	Gross Premiums	Net Premiums[a]
2	$ 208.8	$ 474.5	$ 337.2
3	216.1	450.3	320.0
4	222.2	427.3	303.6
5	227.0	405.4	288.1
6	230.7	384.6	273.3
7	233.5	364.8	259.2
8	235.3	346.0	245.9
9	236.3	328.1	233.2
10	236.5	311.2	221.1
11	236.0	295.1	209.7
12	235.0	279.7	198.8
13	233.4	265.2	188.5
14	231.3	251.4	178.6
15	228.7	238.3	169.3
16	225.8	225.8	160.5
17	222.5	214.0	152.1
18	219.0	202.8	144.1
19	215.1	192.1	136.5
20	211.1	182.0	129.3
Total	$ 4,304.4	$ 5,838.4	$ 4,149.0
Present value [b]	$ 4,304.4	$ 5,838.4	$ 4,149.0

(a) Gross premiums × 71.1% net premium ratio.

(b) 0% discount rate.

Present value of future benefits (for Years 2–20)	$ 4,304.4
Less: Present value of future net premiums (for Years 2–20)	4,149.0
Liability for future policy benefits	$ 155.4

Accounting Entries (Year 1)

Cash [a]	$ 300.0	
Benefits expense [b]	355.4	
Premium income		$ 500.0
Liability for future policy benefits		155.4

(a) Premiums collected of $500.0, less benefits paid of $200.0.

(b) Benefits paid of $200.0, plus change in reserve of $155.4.

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55-29M At the end of Year 6, the Entity updates its mortality assumption to reflect the unfavorable experience in that year (that is, the true-up from expected experience to actual experience) and its effect on estimated cash flows. However, as specified in paragraph 944-40-35-5(a), the Entity reviewed its future cash flow assumptions and determined that its future mortality and lapse assumptions did not need to be adjusted.

The following table provides information about the estimated cash flow effects of updating cash flow assumptions and the corresponding adjustment to the liability for future policy benefits and current-period benefit expense.

	Original Cash Flow Estimate		Updated Cash Flow Estimate [a]		Change	
Year	Benefits	Gross Premiums	Benefits	Gross Premiums	Benefits	Gross Premiums
1	$ 200.0	$ 500.0	$ 200.0	$ 500.0	$ -	$ -
2	208.8	474.5	208.8	474.5	-	-
3	216.1	450.3	216.1	450.3	-	-
4	222.2	427.3	222.2	427.3	-	-
5	227.0	405.4	227.0	405.4	-	-
6	230.7	384.6	276.9	384.6	46.1	-
7	233.5	364.8	233.4	364.7	(0.1)	(0.1)
8	235.3	346.0	235.2	345.9	(0.1)	(0.1)
9	236.3	328.1	236.2	328.0	(0.1)	(0.1)
10	236.5	311.2	236.4	311.1	(0.1)	(0.1)
11	236.0	295.1	236.0	295.0	(0.1)	(0.1)
12	235.0	279.7	234.9	279.7	(0.1)	(0.1)
13	233.4	265.2	233.3	265.1	(0.1)	(0.1)
14	231.3	251.4	231.2	251.3	(0.1)	(0.1)
15	228.7	238.3	228.7	238.2	(0.1)	(0.1)
16	225.8	225.8	225.7	225.7	(0.1)	(0.1)
17	222.5	214.0	222.5	213.9	(0.1)	(0.1)
18	219.0	202.8	218.9	202.7	(0.1)	(0.1)
19	215.1	192.1	215.1	192.0	(0.1)	(0.1)
20	211.1	182.0	211.0	181.9	(0.1)	(0.1)
Total	$ 4,504.4	$ 6,338.4	$ 4,549.6	$ 6,337.3	$ 45.2	$ (1.1)
Present value [b]	$ 4,504.4	$ 6,338.4	$ 4,549.6	$ 6,337.3	$ 45.2	$ (1.1)
Net premium ratio [c]	71.1%		71.8%			

(a) Benefits and gross premiums for Years 1–6 represent actual (historical) cash flows. Years 7–20 represent expected (future) cash flows.
(b) 0% discount rate.
(c) Present value of benefits/present value of gross premiums (for Years 1–20).

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Remeasurement of Liability for Future Policy Benefits (Beginning of Year 6)						
	Original Estimate			Updated Estimate		
Year	Benefits	Gross Premiums	Net Premiums[a]	Benefits	Gross Premiums	Net Premiums[b]
6	$ 230.7	$ 384.6	$ 273.3	$ 276.9	$ 384.6	$ 276.1
7	233.5	364.8	259.2	233.4	364.7	261.8
8	235.3	346.0	245.9	235.2	345.9	248.3
9	236.3	328.1	233.2	236.2	328.0	235.5
10	236.5	311.2	221.1	236.4	311.1	223.3
11	236.0	295.1	209.7	236.0	295.0	211.8
12	235.0	279.7	198.8	234.9	279.7	200.8
13	233.4	265.2	188.5	233.3	265.1	190.3
14	231.3	251.4	178.6	231.2	251.3	180.4
15	228.7	238.3	169.3	228.7	238.2	171.0
16	225.8	225.8	160.5	225.7	225.7	162.1
17	222.5	214.0	152.1	222.5	213.9	153.6
18	219.0	202.8	144.1	218.9	202.7	145.5
19	215.1	192.1	136.5	215.1	192.0	137.9
20	211.1	182.0	129.3	211.0	181.9	130.6
Total	$ 3,430.2	$ 4,081.0	$ 2,900.1	$ 3,475.4	$ 4,079.8	$ 2,928.9
Present value [c]	$ 3,430.2	$ 4,081.0	$ 2,900.1	$ 3,475.4	$ 4,079.8	$ 2,928.9

(a) Gross premiums × 71.1% net premium ratio.
(b) Gross premiums × 71.8% net premium ratio.
(c) 0% discount rate.

	Original Estimate	Updated Estimate	Change
Present value of future benefits (for Years 6–20)	$ 3,430.2	$ 3,475.4	$ 45.2
Less: Present value of future net premiums (for Years 6–20)	2,900.1	2,928.9	28.8
Liability for future policy benefits	$ 530.1	$ 546.5	$ 16.4

Liability for Future Policy Benefits (End of Year 6)			
Year	Benefits	Gross Premiums	Net Premiums[a]
7	$ 233.4	$ 364.7	$ 261.8
8	235.2	345.9	248.3
9	236.2	328.0	235.5
10	236.4	311.1	223.3
11	236.0	295.0	211.8
12	234.9	279.7	200.8
13	233.3	265.1	190.3
14	231.2	251.3	180.4

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15	228.7	238.2	171.0
16	225.7	225.7	162.1
17	222.5	213.9	153.6
18	218.9	202.7	145.5
19	215.1	192.0	137.9
20	211.0	181.9	130.6
Total	$ 3,198.5	$ 3,695.3	$ 2,652.8
Present value[b]	$ 3,198.5	$ 3,695.3	$ 2,652.8

(a) Gross premiums × 71.8% net premium ratio.
(b) 0% discount rate.

Present value of future benefits (for Years 7–20)	$ 3,198.5
Less: Present value of future net premiums (for Years 7–20)	2,652.8
Liability for future policy benefits	$ 545.7

Accounting Entries (Year 6)

Cash [a]	$ 107.7	
Benefits expense [b]	276.1	
Liability remeasurement loss [c]	16.4	
Premium income		$ 384.6
Liability for future policy benefits [d]		15.6

(a) Premiums collected of $384.6, less benefits paid of $276.9.
(b) Benefits paid of $276.9, less change in reserve of $0.8 using current net premium ratio of 71.8%.
(c) Separately presented in the statement of operations.
(d) Liability remeasurement of $16.4, less current period change in reserve of $0.8.

55-29N At the end of Year 9, the Entity reviews and updates its mortality assumption to reflect the unfavorable experience in that year and an increase in expected mortality in Years 10 through 20.

The following tables provide information about the estimated cash flow effects of updating the mortality assumption and the corresponding adjustment to the liability for future policy benefits and current-period benefit expense.

	Prior Cash Flow Estimate		Updated Cash Flow Estimate [a]		Change	
Year	Benefits	Gross Premiums	Benefits	Gross Premiums	Benefits	Gross Premiums
1	$ 200.0	$ 500.0	$ 200.0	$ 500.0	$ -	$ -
2	208.8	474.5	208.8	474.5	-	-
3	216.1	450.3	216.1	450.3	-	-
4	222.2	427.3	222.2	427.3	-	-
5	227.0	405.4	227.0	405.4	-	-
6	276.9	384.6	276.9	384.6	-	-
7	280.1	364.7	280.1	364.7	-	-

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8	282.2	345.8	282.2	345.8	-	-
9	236.0	327.8	283.2	327.8	47.2	-
10	236.3	310.9	283.4	310.8	47.2	(0.1)
11	235.8	294.8	282.8	294.6	47.0	(0.2)
12	234.8	279.5	281.4	279.2	46.6	(0.3)
13	233.1	264.9	279.3	264.5	46.2	(0.4)
14	231.1	251.1	276.7	250.6	45.7	(0.5)
15	228.5	238.0	273.5	237.4	45.0	(0.6)
16	225.6	225.6	269.9	224.9	44.3	(0.7)
17	222.3	213.8	265.9	213.0	43.5	(0.7)
18	218.8	202.6	261.5	201.8	42.7	(0.8)
19	214.9	191.9	256.8	191.0	41.8	(0.9)
20	210.9	181.8	251.8	180.9	40.9	(0.9)
Total	$ 4,641.4	$ 6,335.3	$ 5,179.5	$ 6,329.1	$ 538.1	$ (6.1)
Present value [b]	$ 4,641.4	$ 6,335.3	$ 5,179.5	$ 6,329.1	$ 538.1	$ (6.1)
Net premium ratio [c]	73.3%		81.8%			

(a) Benefits and gross premiums for Years 1–9 represent actual (historical) cash flows. Years 10–20 represent expected (future) cash flows.

(b) 0% discount rate.

(c) Present value of benefits/present value of gross premiums (for Years 1-20).

Remeasurement of Liability for Future Policy Benefits (Beginning of Year 9)

	Prior Estimate			Updated Estimate		
Year	Benefits	Gross Premiums	Net Premiums[a]	Benefits	Gross Premiums	Net Premiums[b]
9	$ 236.0	$ 327.8	$ 240.2	$ 283.2	$ 327.8	$ 268.3
10	236.3	310.9	227.8	283.4	310.8	254.3
11	235.8	294.8	216.0	282.8	294.6	241.1
12	234.8	279.5	204.7	281.4	279.2	228.4
13	233.1	264.9	194.1	279.3	264.5	216.5
14	231.1	251.1	184.0	276.7	250.6	205.1
15	228.5	238.0	174.4	273.5	237.4	194.3
16	225.6	225.6	165.3	269.9	224.9	184.1
17	222.3	213.8	156.6	265.9	213.0	174.3
18	218.8	202.6	148.4	261.5	201.8	165.1
19	214.9	191.9	140.6	256.8	191.0	156.3
20	210.9	181.8	133.2	251.8	180.9	148.0
Total	$ 2,728.1	$ 2,982.7	$ 2,185.2	$ 3,266.2	$ 2,976.6	$ 2,435.9
Present value [c]	$ 2,728.1	$ 2,982.7	$ 2,185.2	$ 3,266.2	$ 2,976.6	$ 2,435.9

(a) Gross premiums × 73.3% net premium ratio.

(b) Gross premiums × 81.8% net premium ratio.

(c) 0% discount rate.

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	Prior Estimate	Updated Estimate	Change
Present value of future benefits (for Years 9–20)	$ 2,728.1	$ 3,266.2	$ 538.1
Less: Present value of future net premiums (for Years 9–20)	2,185.2	2,435.9	250.7
Liability for future policy benefits	$ 542.9	$ 830.3	$ 287.4

Liability for Future Policy Benefits (End of Year 9)

Year	Benefits	Gross Premiums	Net Premiums[a]
10	$ 283.4	$ 310.8	$ 254.3
11	282.8	294.6	241.1
12	281.4	279.2	228.4
13	279.3	264.5	216.5
14	276.7	250.6	205.1
15	273.5	237.4	194.3
16	269.9	224.9	184.1
17	265.9	213.0	174.3
18	261.5	201.8	165.1
19	256.8	191.0	156.3
20	251.8	180.9	148.0
Total	$ 2,983.0	$ 2,648.7	$ 2,167.6
Present value [b]	$ 2,983.0	$ 2,648.7	$ 2,167.6

(a) Gross premiums × 81.8% net premium ratio.

(b) 0% discount rate.

Present value of future benefits (for Years 10–20)	$ 2,983.0
Less: Present value of future net premiums (for Years 10–20)	2,167.6
Liability for future policy benefits	$ 815.4

Accounting Entries (Year 9)

Cash [a]	$ 44.6	
Benefits expense [b]	268.3	
Liability remeasurement loss [c]	287.4	
Premium income		$ 327.8
Liability for future policy benefits [d]		272.5

(a) Premiums collected of $327.8, less benefits paid of $283.2.

(b) Benefits paid of $283.2, less change in reserve of $14.9 using current net premium ratio of 81.8%.

(c) Separately presented in the statement of operations.

(d) Liability remeasurement of $287.4, less current period change in reserve of $14.9.

55-29O At the end of Year 10, the Entity updates its discount rate assumption from 0 percent to 2 percent.

The following table provides information about the effect of updating the discount rate assumption and the adjustment to the liability for future policy benefits and other comprehensive income.

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Liability for Future Policy Benefits (End of Year 10)			
	Original Discount Rate 0%	Current Discount Rate 2%	Change
Present value of future benefits (for Years 11–20)	$ 2,699.6	$ 2,430.0	$ (269.6)
Less: Present value of future net premiums (for Years 11–20)	1,913.3	1,733.8	(179.5)
Liability for future policy benefits	$ 786.3	$ 696.2	$ (90.1)

Decrease to Liability for Future Policy Benefits (End of Year 10)		
Liability for future policy benefits	$ 90.1	
Other comprehensive income		$ 90.1

• > Example 7: Updating of Assumptions Used in the Measurement of the Liability for Future Policy Benefits with a Carryover Basis

55-29P This Example illustrates an approach to updating assumptions used to measure the liability for future policy benefits with a carryover basis.

55-29Q This Example assumes the following for the contracts discussed:

a. The beginning of Year 4 carryover basis is $387.6, which will be used in subsequent recalculations of the net premium ratio.
b. At the beginning of Year 4, the Entity updates cash flow assumptions and recalculates net premiums.
c. A discount rate of 0 percent is used to compute the net premiums and the liability for future policy benefits.
d. For ease of illustration, no expenses are assumed, benefit payments and premium receipts are made at the end of the year, and annual periods are presented.

55-29R This Example illustrates computations that involve the following:

a. Net premiums
b. Updates of the net premium ratio.

55-29S At the beginning of Year 4, the Entity recalculates the net premiums as follows.

Net Premium Ratio

Year	Benefits	Gross Premiums
4	$ 222.2	$ 427.3
5	227.0	405.4
6	276.9	384.6
7	233.4	364.7
8	235.2	345.9
9	236.2	328.0
10	236.4	311.1
11	236.0	295.0
12	234.9	279.7
13	233.3	265.1

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14			231.2		251.3
15			228.7		238.2
16			225.7		225.7
17			222.5		213.9
18			218.9		202.7
19			215.1		192.0
20			211.0		181.9
Total			$ 3,924.6		$ 4,912.5
Present value [a]			$ 3,924.6		$ 4,912.5

(a) 0% discount rate.

Present value of benefits (for Years 4–20)	(A)	$ 3,924.6	
Carrying value of the liability for future policy benefits (end of Year 3)	(B)	387.6	
Expected remaining benefits	(A) – (B) = (C)	3,537.0	
Present value of gross premiums (for Years 4–20)			(D) $ 4,912.5
Updated net premium ratio = (C)/(D)			72.0%

55-29T The computation of the liability for future policy benefits at the end of Year 4 using the revised net premiums follows.

Liability for Future Policy Benefits (End of Year 4)

Year	Benefits	Gross Premiums	Net Premiums[a]
5	$ 227.0	$ 405.4	$ 291.9
6	276.9	384.6	276.9
7	233.4	364.7	262.6
8	235.2	345.9	249.0
9	236.2	328.0	236.2
10	236.4	311.1	224.0
11	236.0	295.0	212.4
12	234.9	279.7	201.4
13	233.3	265.1	190.9
14	231.2	251.3	180.9
15	228.7	238.2	171.5
16	225.7	225.7	162.5
17	222.5	213.9	154.0
18	218.9	202.7	145.9
19	215.1	192.0	138.3
20	211.0	181.9	131.0
Total	$ 3,702.4	$ 4,485.2	$ 3,229.4
Present value[b]	$ 3,702.4	$ 4,485.2	$ 3,229.4

(a) Gross premiums × 72.0% net premium ratio.
(b) 0% discount rate.

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Present value of future benefits (for Years 5–20)		$ 3,702.4
Less: Present value of future net premiums (for Years 5–20)		3,229.4
Liability for future policy benefits		$ 473.0

55-29U At the end of Year 6, the Entity reviews and updates its mortality assumption as specified in paragraph 944-40-35-5(a), which results in an adjustment to benefit expenses and the liability for future policy benefits.

Net Premium Ratio

Year [a]	Benefits	Gross Premiums
4	$ 222.2	$ 427.3
5	227.0	405.4
6	276.9	384.6
7	280.1	364.7
8	282.2	345.8
9	283.2	327.8
10	283.4	310.8
11	282.8	294.6
12	281.4	279.2
13	279.3	264.5
14	276.7	250.6
15	273.5	237.4
16	269.9	224.9
17	265.9	213.0
18	261.5	201.8
19	256.8	191.0
20	251.8	180.9
Total	$ 4,554.6	$ 4,904.3
Present value [b]	$ 4,554.6	$ 4,904.3

(a) Benefits and gross premiums for Years 4–6 represent actual (historical) cash flows. Years 7–20 represent expected (future) cash flows.

(b) 0% discount rate.

Present value of benefits (for Years 4–20)	(A)	$ 4,554.6	
Carrying value of the liability for future policy benefits (end of Year 3)	(B)	387.6	
Expected remaining benefits	(A) – (B) = (C)	4,167.0	
Present value of gross premiums (for Years 4–20)			(D) $ 4,904.3
Updated net premium ratio = (C)/(D)			85.0%

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Remeasurement of Liability for Future Policy Benefits (Beginning of Year 6)						
	Original Estimate			Updated Estimate		
Year	Benefits	Gross Premiums	Net Premiums[a]	Benefits	Gross Premiums	Net Premiums[b]
6	$ 276.9	$ 384.6	$ 276.9	$ 276.9	$ 384.6	$ 326.8
7	233.4	364.7	262.6	280.1	364.7	309.9
8	235.2	345.9	249.0	282.2	345.8	293.8
9	236.2	328.0	236.2	283.2	327.8	278.5
10	236.4	311.1	224.0	283.4	310.8	264.0
11	236.0	295.0	212.4	282.8	294.6	250.3
12	234.9	279.7	201.4	281.4	279.2	237.2
13	233.3	265.1	190.9	279.3	264.5	224.8
14	231.2	251.3	180.9	276.7	250.6	213.0
15	228.7	238.2	171.5	273.5	237.4	201.8
16	225.7	225.7	162.5	269.9	224.9	191.1
17	222.5	213.9	154.0	265.9	213.0	181.0
18	218.9	202.7	145.9	261.5	201.8	171.4
19	215.1	192.0	138.3	256.8	191.0	162.3
20	211.0	181.9	131.0	251.8	180.9	153.7
Total	$ 3,475.4	$ 4,079.8	$ 2,937.5	$ 4,105.4	$ 4,071.6	$ 3,459.5
Present value [c]	$ 3,475.4	$ 4,079.8	$ 2,937.5	$ 4,105.4	$ 4,071.6	$ 3,459.5

(a) Gross premiums × 72.0% net premium ratio.
(b) Gross premiums × 85.0% net premium ratio.
(c) 0% discount rate.

	Original Estimate	Updated Estimate	Change
Present value of future benefits (for Years 6–20)	$ 3,475.4	$ 4,105.4	$ 630.0
Less: Present value of future net premiums (for Years 6–20)	2,937.5	3,459.5	522.0
Liability for future policy benefits	$ 537.9	$ 645.9	$ 108.0

Liability for Future Policy Benefits (End of Year 6)			
Year	Benefits	Gross Premiums	Net Premiums[a]
7	$ 280.1	$ 364.7	$ 309.9
8	282.2	345.8	293.8
9	283.2	327.8	278.5
10	283.4	310.8	264.0
11	282.8	294.6	250.3
12	281.4	279.2	237.2
13	279.3	264.5	224.8
14	276.7	250.6	213.0

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15	273.5	237.4	201.8
16	269.9	224.9	191.1
17	265.9	213.0	181.0
18	261.5	201.8	171.4
19	256.8	191.0	162.3
20	251.8	180.9	153.7
Total	$ 3,828.5	$ 3,687.1	$ 3,132.7
Present value [b]	$ 3,828.5	$ 3,687.1	$ 3,132.7

(a) Gross premiums × 85.0% net premium ratio.
(b) 0% discount rate.

Present value of future benefits (for Years 7–20)	$ 3,828.5
Less: Present value of future net premiums (for Years 7–20)	3,132.7
Liability for future policy benefits	$ 695.8

Accounting Entries (Year 6)

Cash [a]	$ 107.7	
Benefits expense [b]	326.8	
Liability remeasurement loss [c]	108.0	
Premium income		$ 384.6
Liability for future policy benefits [d]		157.9

(a) Premiums collected of $384.6, less benefits paid of $276.9.
(b) Benefits paid of $276.9, plus change in reserve of $49.9 using current net premium ratio of 85.0%.
(c) Separately presented in the statement of operations.
(d) Liability remeasurement of $108.0, plus current period change in reserve of $49.9.

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3. Market risk benefits

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3.1 How the standard works

ASU 2018-12 amends legacy US GAAP for certain market-based options or guarantees associated with deposit (or account balance) contracts by creating a new term for certain contracts or contract features that provide benefits in addition to the contract holder's account balance.

The ASU requires measurement at fair value with changes recorded in income, except for changes in instrument-specific credit risk.

Comparison to legacy US GAAP Legacy US GAAP vs ASU 2018-12

The following table summarizes the key changes from legacy US GAAP for the market-based options and guarantees discussed above.

Legacy US GAAP	ASU 2018-12
Two measurement models were used to value benefits in addition to the account balance: [944-40-30-20 – 30-25] • fair value model for an embedded derivative; or • the insurance benefit model sometimes referred to as the SOP 03-1 model. The model used depended on the characteristics of the benefit.	• A new defined term is introduced: 'market risk benefits' (MRBs). • There is one measurement model (fair value) for all MRBs associated with deposit (or account balance) contracts. • Separate presentation of changes in fair value on the face of the income statement, except for changes attributable to instrument-specific credit risk. • Separate recognition in OCI of changes in fair value attributable to a change in the instrument-specific credit risk of MRBs.

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3.2 Overview

Over time, the insurance industry has developed contracts or contract features that allow insurance contract holders to participate in the risks and rewards of the capital markets. Features have been added that provide the contract holder with protection from capital market risk by requiring the entity to cover a shortfall between the guaranteed benefit and the account balance – i.e. the net amount at risk. [ASU 2018-12.BC66–BC67]

While these features may protect the contract holder from the risks of the capital markets, the entity itself remains exposed to those risks. These contract features may exist in fixed and variable annuity contracts, investment contracts, and in certain life insurance contracts. They include guaranteed minimum benefit features (GMXBs), such as: [ASU 2018-12.BC66]

- guaranteed minimum death benefits (GMDBs);
- guaranteed minimum accumulation benefits (GMABs);
- guaranteed minimum income benefits (GMIBs);
- guaranteed minimum withdrawal benefits (GMWBs); and
- guaranteed lifetime withdrawal benefits (GLWBs).

Under legacy US GAAP, the accounting analysis for certain contracts and contract benefits could be complex – e.g. determining whether a contract or contract feature was an embedded derivative recognized at fair value or an insurance benefit. [ASU 2018-12.BC68]

Under ASU 2018-12, all contracts and contract features that meet the definition of an MRB are recognized at fair value. This change results in greater uniformity in measuring similar contract features and better reflects their inherent risk and economics. It also better aligns with the fair value measurement of derivatives used to hedge capital market risk. [ASU 2018-12.BC68, BC75]

3.3 Identifying MRBs

Excerpt from ASC 944-40

Long-Duration Contracts

> Universal Life-Type Contracts and Nontraditional Contract Benefits

• > Additional Liability

• • > Market Risk Benefits

25-25C A contract or contract feature that both provides protection to the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk shall be recognized as a **market risk benefit**.

25-25D In evaluating whether a contract or contract feature meets the conditions in paragraph 944-40-25-25C, an insurance entity shall consider that:

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a. Protection refers to the transfer of a loss in, or shortfall (that is, the difference between the account balance and the benefit amount) of, the contract holder's account balance from the contract holder to the insurance entity, with such transfer exposing the insurance entity to capital market risk that would otherwise have been borne by the contract holder (or beneficiary).
b. Protection does not include the death benefit component of a life insurance contract (that is the difference between the account balance and the death benefit amount). This condition does not apply to an investment contract or an annuity contract (including an annuity contract classified as an insurance contract).
c. A nominal risk, as explained in paragraph 944-20-15-21, is a risk of insignificant amount or a risk that has a remote probability of occurring. A market risk benefit is presumed to expose the insurance entity to other-than-nominal capital market risk if the benefit would vary more than an insignificant amount in response to capital market volatility.

• • > Annuitization Benefits

25-26 This guidance addresses contract features that provide for potential benefits in addition to the account balance that are payable only upon **annuitization**, such as annuity purchase guarantees or **guaranteed minimum income benefits** that are not market risk benefits, and two-tier annuities.

25-27 If the contract feature is not required to be accounted for under paragraph 944-40-25-25C or the provisions of Topic 815 on derivatives and hedging, an additional liability for the contract feature shall be established if the present value of expected annuitization payments at the expected annuitization date exceeds the expected account balance at the expected annuitization date.

• • > Death or Other Insurance Benefits

25-27A If the contract feature is not required to be accounted for under paragraph 944-40-25-25C or the provisions of Topic 815 on derivatives and hedging and if the amounts assessed against the contract holder each period for the insurance benefit feature of an insurance contract are assessed in a manner that is expected to result in profits in earlier years and losses in subsequent years from the insurance benefit function, a liability for death or other insurance benefits shall be recognized in addition to the account balance.

20 Glossary

Guaranteed Minimum Income Benefit

A guarantee that, regardless of account balance performance, the contract holder will be able to annuitize after a specified date and receive a defined minimum periodic benefit. These benefits are available only if the contract holder elects to annuitize.

Market Risk Benefit

A contract or contract feature in a long-duration contract issued by an insurance entity that both protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk.

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Question 3.3.10 When does a contract or contract feature meet the definition of an MRB?

Interpretive response: Determining whether a contract or contract feature meets the definition of an MRB requires judgment. The effect of capital market risk to both the contract holder and the entity is evaluated to conclude whether a contract or contract feature contains an MRB. [944-40-25-25C]

Additional guidance explains how to evaluate 'protect' and 'other-than-nominal' in the definition of an MRB. [944-40-25-25D]

- Protect is the obligation of the entity to fund the amount by which the guaranteed benefit exceeds the account balance when the entity is exposed to capital market risk. The guaranteed benefit is the amount the contract holder would receive on death, annuitization or withdrawal.
- A nominal risk is a risk of insignificant amount or a risk that has a remote probability of occurring. A contract or contract feature is presumed to have other-than-nominal capital market risk if the benefit would vary more than an insignificant amount in response to capital market volatility.

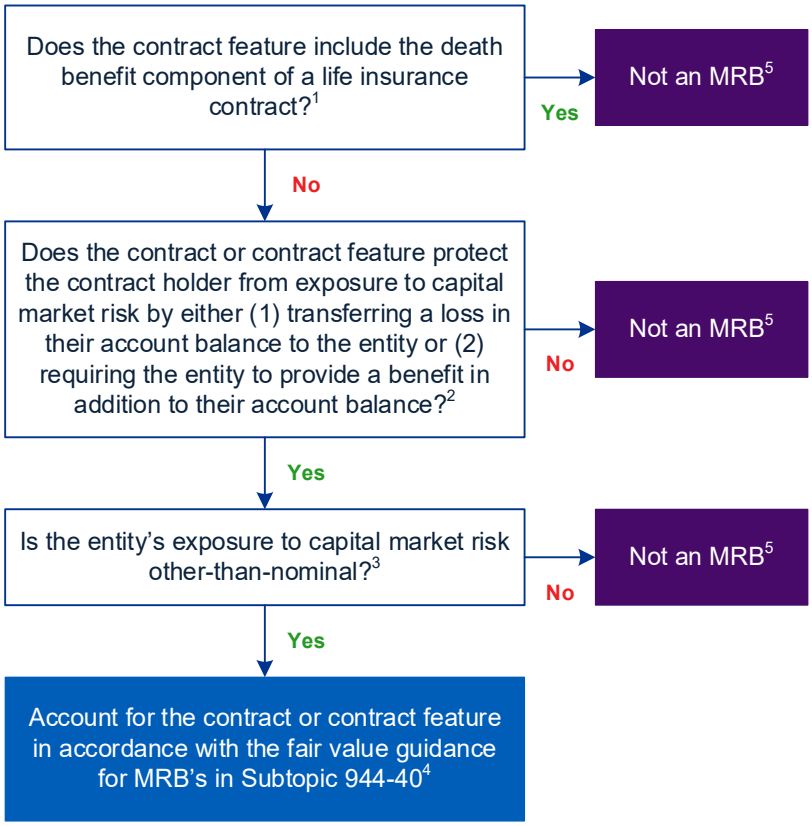
An MRB can exist in different insurance contract features. However, an MRB excludes the contractual death benefit component of a life insurance contract.

When evaluating whether contract features meet the definition of an MRB, an entity should consider these points: [944-40-25-25D]

- the nature of the contract or contract feature;
- whether a benefit in addition to the account balance is provided; and
- whether the entity is exposed to the capital markets and, if so, whether the exposure is other-than-nominal.

The following decision tree can assist in determining if a contract or contract feature meets the definition of an MRB.

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Notes:

1. See Question 3.3.30
2. See Observation: Capital market risk
3. See section 3.3
4. See section 3.4
5. See Question 3.3.40

The following diagrams illustrate possible conclusions when evaluating whether certain contract features in the insurance marketplace meet the definition of an MRB. However, the specific facts and circumstances of each contract and contract feature should be analyzed before reaching a conclusion.

The following contract features meet the definition of an MRB.

GMXBs – e.g. GLWB, GMAB, GMDB, GMIB, GMWB

- Both protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk.
- Can be present in both fixed and variable contracts.

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The following contract features do *not* meet the definition of an MRB.

Equity-indexed component	Death benefit – e.g. fixed benefit on a variable life insurance contract
Does not meet the definition of protection – i.e. does not result in a benefit in addition to the account balance. [944-40-25-25D(b)]	Does not meet the definition of protection – i.e. death benefit component is excluded from scope [944-40-25-25D(b)]
Interest credited, including guaranteed minimums	**No lapse / secondary guarantee on an insurance contract**
Does not meet the definition of protection – i.e. does not result in a benefit in addition to the account balance. [944-40-25-25D(b)]	Does not meet the definition of protection – i.e. death benefit component is excluded from scope; does not transfer a loss; does not include a capital market component. [944-40-25-25D(a) – 25D(b), 944-40-55-14]

Observation Capital market risk

Although capital market risk is not defined in ASU 2018-12, the FASB stated in the basis for conclusions that capital market risk includes equity, interest rate and foreign exchange risk. Further, it influences the variability of a benefit amount (i.e. the net amount at risk), which involves comparing the guaranteed amount to the account balance. Capital market risk exists when an entity insures a shortfall between a contract holder's account balance and a guaranteed amount that is caused by poor capital market performance. [ASU 2018-12.BC71, BC73–BC74]

Observation Guaranteed annuitization rate contract features

Guaranteed annuitization rate contract features provide a benefit that protects the contract holder's account balance from capital market volatility – i.e. guarantees of the interest rate or of the annuitization amounts. Topic 944 presumes that a contract or contract feature protects the contract holder from other-than-nominal capital market risk if the benefit would vary more than an insignificant amount in response to capital market volatility. Because of this presumption, entities need to evaluate guaranteed annuitization rate contract features to determine whether they would vary more than an insignificant amount in response to capital market volatility. [944-40-25-25D(c)]

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Question 3.3.20 Can capital market risk exist with discretionary interest crediting rates?

Interpretive response: Yes. An entity evaluates whether a contract or contract feature exposes it to capital market risk and provides a benefit in addition to the account balance. For this evaluation, we believe that capital market risk can exist with either a contractually specified or a discretionary interest crediting rate. Whether contractually specified or discretionary, interest crediting rates do not meet the definition of protection if they do not result in a benefit in addition to the account balance. [944-40-25-25D]

However, a contract feature with discretionary interest crediting rates that provides an other-than-nominal potential benefit in addition to the account balance may meet the definition of an MRB – e.g. guaranteed annuitization rate. [944-40-25-25D]

The FASB stated in ASU 2018-12's basis for conclusions that capital market risk includes equity, interest rate and foreign exchange risk. For additional discussion of capital market risk, see Observation: Capital market risk. [ASU 2018-12.BC71]

Question 3.3.10 addresses considerations in evaluating whether certain other benefits are MRBs.

Question 3.3.30 Is the contractual death benefit of a life insurance contract an MRB?

Interpretive response: No. The contractual death benefit component of a life insurance contract (or the amount by which the death benefit amount exceeds the account balance) is excluded from the definition of an MRB. [944-40-25-25D(b)]

This exclusion is specific to a life insurance contract and does not apply to either an investment contract or an annuity contract. These contract definitions focus on the legal product form rather than the accounting contract definitions in Topic 944. [944-40-25-25D(b)]

Question 3.3.10 addresses considerations in evaluating whether certain other benefits are MRBs.

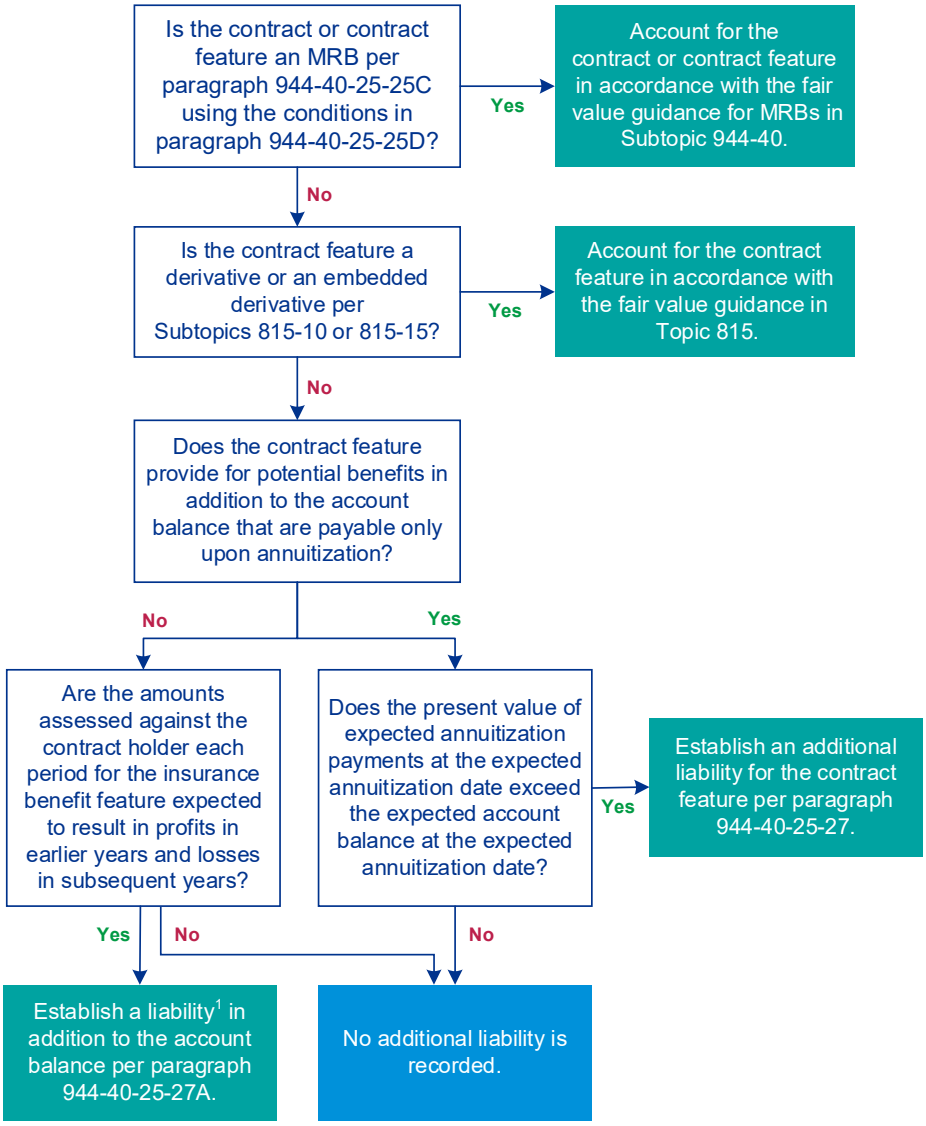
Question 3.3.40 In what order does an entity evaluate accounting models when determining applicability to contracts that include benefits in addition to the account balance?

Interpretive response: For universal life-type contracts and nontraditional contract benefits that include benefits in addition to the account balance, an assessment of the appropriate accounting treatment for each individual contract or contract feature is made at issuance. The entity should determine the accounting for the contract or contract feature in the following order: [944-40-25-25B]

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- MRB;
- embedded derivative; and then
- annuitization, death or other insurance benefit.

Certain contract features that were previously embedded derivatives may now be MRBs. The following decision tree can assist in determining the appropriate accounting treatment for contracts and contract features that include benefits in addition to the account balance. [944-40-25-25B, 25-26 – 25-27A]



Note:

1. Liability for death or other insurance benefits.

For example, an entity sells a fixed-indexed annuity contract with a GMDB feature. The entity evaluates the contract and contract features using the decision tree.

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- The GMDB contract feature qualifies as an MRB per paragraph 944-40-25-25C because it protects the contract holder from other-than-nominal capital market risk and exposes the entity to other-than-nominal capital risk. The entity would account for the GMDB contract feature as an MRB under the fair value guidance for MRBs in Subtopic 944-40. [944-40-40-25D]
- The equity-index contract feature does not qualify as an MRB per paragraph 944-40-25-25C. It does not meet the definition of protection because the benefit only defines the crediting rate to apply to the account balance. The entity would then need to evaluate the equity index contract feature to determine whether it meets the definition of a derivative or an embedded derivative in Topic 815.

For further guidance, see KPMG Handbook, Derivatives and hedging.

Question 3.3.50 How does an entity perform the MRB assessment of a variable annuity contract with multiple investment options?

Interpretive response: We believe an entity performs its assessment of whether an MRB exists for the individual variable annuity contract in totality – i.e. before allocating the variable annuity contract to its general account or separate account units of measurement. A liability for the insurance benefit that is in addition to the account balance may be recognized for reasons other than capital market risk.

For a decision tree to assist in determining the accounting treatment for contracts and contract features that include benefits in addition to the account balance, see Question 3.3.40.

Question 3.3.60 Is a disability or health insurance benefit feature of a universal life-type contract an MRB?

Interpretive response: No. We believe that disability and health insurance benefit features (e.g. long-term care) of a universal life-type contract meet the MRB definition exception. We believe this exception applies whether the universal life-type contract is defined as a universal disability contract or universal health contract, or as a rider to a universal life insurance contract. Therefore, we do not believe that a disability or health insurance benefit feature of a universal life-type contract is required to be assessed under the MRB definition. [944-40-25-25D(b)]

Under ASU 2018-12, the contractual death benefit component of a life insurance entity is explicitly excluded from the definition of an MRB. Further, the exclusion explicitly prohibits application to either an investment contract or an annuity contract. However, ASU 2018-12 does not address the MRB scoping assessment for disability and health insurance benefit features of a universal life-type contract. [944-40-25-25D(b)]

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Yet, insurance contracts that have similar characteristics to a universal life-type contract are in the scope of the long-duration contract subsections of Topic 944. For example, universal disability contracts with many of the same characteristics as universal life-type contracts (except for providing disability benefits instead of life insurance benefits) are accounted for in a manner consistent with universal life-type contracts. [944-20-15-12]

Therefore, because a contract feature provides disability or health insurance benefits that are similar to life insurance benefits for a similar universal life-type contract, we believe that the contract feature is similarly excluded from the definition of an MRB.

Question 3.3.70 What capital market risk scenarios are considered in the other-than-nominal capital market risk assessment?

Interpretive response: We believe an entity considers a range of capital market risk scenarios to evaluate whether a benefit has an other-than-nominal capital market risk. However, we also believe the range of capital market risk scenarios considered may exclude those that have a remote probability of occurring. A nominal risk is a risk of insignificant amount or a risk that has a remote probability of occurring. [944-40-25-25D]

If a range of capital market risk scenarios results in a benefit that varies by more than an insignificant amount in response to capital market risk, an entity then assesses the probability of that variability in those capital market risk scenarios occurring.

- If the probability of that variability is more than remote, then the benefit meets the definition of an MRB because it exposes the entity to other-than-nominal capital market risk.
- If the probability of that variability is remote, then the capital market risk is nominal and the benefit does not meet the definition of an MRB.

Question 3.3.80 Is the capital market risk assessment the same when evaluating whether an MRB exists versus whether to recognize an additional liability?

Interpretive response: Yes. We do not believe an entity can reach a different conclusion on whether capital market risk is nominal when determining whether the same contract or contract feature:

- meets the definition of an MRB, versus
- requires the entity to establish an additional liability when it is determined not to be an MRB.

At inception, an entity evaluates a long-duration contract's terms and characteristics to determine its accounting classification. When distinguishing universal life-type insurance contracts from investment contracts, there is a

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rebuttable presumption that a contract has significant mortality risk if the additional insurance benefit would vary significantly in response to capital market volatility. [944-20-15-21]

In determining whether a contract or contract feature meets the definition of an MRB, an entity evaluates its exposure to capital market risk, including whether the exposure is other-than-nominal. A contract or contract feature is presumed to have other-than-nominal capital market risk if the benefit provided would vary by more than an insignificant amount in response to capital market volatility. Consequently, a contract or contract feature does not meet the definition of an MRB if it has nominal capital market risk — i.e. it would not vary more than an insignificant amount in response to capital market volatility. See Question 3.3.70. [944-40-25-25D]

When an entity concludes that a universal life-type contract feature is not an MRB or an embedded derivative, the entity determines whether the contract feature provides for potential death, other insurance or annuitization benefits in addition to the account balance. If these additional potential benefits are provided, the entity establishes an additional liability for the contract feature. [944-40-25-25B]

We believe that the evaluation of whether a contract feature has nominal capital market risk is consistent when evaluating: [944-40-25-27 – 25-27A]

- whether it meets the definition of an MRB; and
- the associated mortality and morbidity risk to determine whether an additional liability for the insurance benefit in addition to the account balance is recognized.

An additional liability for the insurance benefit in addition to the account balance may be recognized for reasons other than capital market risk. Question 3.3.40 includes a decision tree to assist in determining the accounting treatment for contracts and contract features that include benefits in addition to the account balance.

Question 3.3.90 Does the assessment of other-than-nominal capital market risk consider the likelihood of paying a death benefit guarantee?

Interpretive response: No. We do not believe that an entity considers its likelihood to pay a death benefit guarantee when assessing whether that contractual feature protects the contract holder from other-than-nominal capital market risk. Instead, we believe that an entity performs the assessment assuming the contract holder's beneficiary will receive the death benefit.

However, if the entity concludes that the benefit is an MRB because it protects the contract holder from other-than-nominal capital market risk, the entity considers the likelihood to pay the death benefit guarantee when measuring the feature's fair value because a market participant would include this assumption. [944-40-25-25D]

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Question 3.3.100 Does the assessment of other-than-nominal capital market risk consider the likelihood that the contract holder will use the contract feature?

Interpretive response: No. When assessing whether a contractual feature protects the contract holder from other-than-nominal capital market risk, we do not believe that an entity considers the likelihood that a contract holder will use the contractual feature. Instead, we believe that an entity performs the assessment assuming the contract holder will use the contract feature.

However, if the entity concludes that the benefit is an MRB because it protects the contract holder from other-than-nominal capital market risk, the entity considers the likelihood that the contract holder will use the contract feature when measuring the MRB's fair value because a market participant would include this assumption. [944-40-25-25D]

For example, when assessing whether an annuitization guarantee contract feature protects the contract holder from other-than-nominal capital market risk and therefore meets the definition on an MRB, we believe that the entity assumes the contract holder will annuitize – i.e. we do not believe that an entity considers the contract holder's likelihood to annuitize. However, if the entity concludes the annuitization contract feature meets the definition of an MRB, it includes an assessment of the likelihood that the contract holder will annuitize when measuring the feature's fair value.

Question 3.3.110 Are mortality assumptions considered in the MRB assessment for annuitization guarantees?

Interpretive response: Yes. We believe an entity considers mortality assumptions in measuring the potential life contingent benefit provided by the annuitization guarantee contract feature – i.e. to determine how long the benefit will be provided under the guarantee. [944-40-25-25D]

Question 3.3.120 Does the assessment of other-than-nominal capital market risk for a variable annuity contract consider the contract holder's expected investment option choices?

Interpretive response: Yes. When determining whether capital market risk is other-than-nominal at contract inception for a variable annuity contract, we believe an entity considers its expectations of the contract holder depositing additional funds and/or re-allocating its funds between different investment options – i.e. general account or separate account options. All contractual cash flows related to the contract or contract feature are included when assessing other-than-nominal capital market risk. Therefore, when the variable annuity contract allows the contract holder to deposit additional funds or change its investment options, an entity considers its expectation of the contract holder's

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investment option choices when determining whether the capital market risk is other-than-nominal. [944-40-25-25D(c)]

For guidance about considering the contract holder's usage of the contract feature, see Question 3.3.100.

Question 3.3.130 What date is used to assess a reinsurance contract for MRBs?

Interpretive response: The MRB assessment is performed as of the date of the reinsurance contract. ASU 2018-12 states that the reinsurance contract is a new contract for measurement and accounting purposes. Therefore, that date is used to perform the assessment to determine whether the contract includes MRBs. [944-805-25-1]

Question 3.3.140 Is the MRB conclusion reassessed subsequent to contract inception?

Interpretive response: No. ASU 2018-12 explicitly states that the MRB assessment is performed at contract inception. There is no guidance that addresses reassessment subsequent to contract inception. Therefore, we do not believe that an entity can reassess its MRB conclusion subsequent to contract inception. [944-40-25-25B(a)]

For further discussion about the contract inception date used to evaluate a reinsurance contract for MRBs, see Question 3.3.130.

Question 3.3.150 Are two-tier annuity contracts evaluated under the MRB guidance?

Background: A two-tier annuity is a type of annuity contract that offers different crediting rates applied to the funds deposited depending on how the contract holder elects to receive the benefit.

It typically provides one crediting rate if the contract holder elects to receive a lump sum. This is often referred to as the lower tier and is used to measure the accrued account balance during the accumulation phase (prior to annuitization), which would be the amount available to the contract holder in cash at maturity if it elects to receive a lump sum.

It also provides a second, typically higher, crediting rate if the contract holder elects to annuitize the contract and receive the benefit as a series of regular payments over time, either for a specified period or the lifetime of the annuitant. This is typically referred to as the upper tier.

Generally, a two-tier annuity is designed to provide a financial incentive for contract holders to annuitize their benefit and keep their funds invested with the insurer for a longer period of time, which can be more beneficial for the insurance company managing the annuity. [944-20 Glossary, 944-40-35-19]

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Interpretive response: Yes. A contract feature in a two-tier annuity meets the definition to be accounted for as an MRB when it both protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk. [944-40-25-25C, 25-25D]

For further discussion about when a contract or contract feature meets the definition of an MRB, see Question 3.3.10.

Further, for contract features that provide potential benefits in addition to the account balance that are payable only upon annuitization and do not meet the definition of an MRB or an embedded derivative, an entity records an additional liability for annuitization benefits during the accumulation phase. For further discussion, see section 2.5.20. [944-40-25-26, 25-27]

For further discussion around when an additional liability is recognized, see Question 2.5.50.

3.4 MRB valuation

All MRBs associated with deposit (or account balance) contracts are measured at fair value. Contracts or contract features that meet the definition of an MRB and for which the additional liability was historically measured using the benefit ratio model are now measured using fair value – e.g. guaranteed minimum death benefits. [944-40-35-19C]

Excerpt from ASC 944-40

Long-Duration Contracts

> Universal Life-Type Contracts and Nontraditional Contract Benefits

• > Additional Liability

• • > Market Risk Benefits

30-19C A **market risk benefit** shall be measured at **fair value**. Total attributed fees used to calculate the fair value of the market risk benefit shall not be negative or exceed total contract fees and assessments collectible from the contract holder.

30-19D In determining the terms of the market risk benefit, the insurance entity shall consider guidance on determining the terms of an embedded derivative that is required to be accounted for separately under Subtopic 815-15 on embedded derivatives, including the following:

a. Consistent with paragraph 815-15-30-4, if a nonoption valuation approach is used, the terms of the market risk benefit shall be determined in a manner that results in its fair value generally being equal to zero at the inception of the contract.
b. Consistent with paragraph 815-15-30-6, if an option-based valuation approach is used, the terms of the market risk benefit shall not be adjusted to result in the market risk benefit being equal to zero at the inception of the contract.

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c. Consistent with paragraph 815-15-25-7, if a contract contains multiple market risk benefits, those market risk benefits shall be bundled together as a single compound market risk benefit.

35-8A A **market risk benefit** may be positive (that is, an asset) or negative (that is, a liability). Changes in **fair value** related to market risk benefits shall be recognized in net income, with the exception of fair value changes attributable to a change in the instrument-specific credit risk of market risk benefits in a liability position. The portion of a fair value change attributable to a change in the instrument-specific credit risk of market risk benefits in a liability position shall be recognized in other comprehensive income (see paragraph 944-40-45-3).

Excerpt from ASC 825-10

Fair Value Option

> Statement of Comprehensive Income

• > Financial Liabilities for Which Fair Value Option Is Elected

45-5 If an entity has designated a financial liability under the fair value option in accordance with this Subtopic or Subtopic 815-15 on embedded derivatives, the entity shall measure the financial liability at fair value with qualifying changes in fair value recognized in net income. The entity shall present separately in other comprehensive income the portion of the total change in the fair value of the liability that results from a change in the instrument-specific credit risk. The entity may consider the portion of the total change in fair value that excludes the amount resulting from a change in a base market risk, such as a risk-free rate or a benchmark interest rate, to be the result of a change in instrument-specific credit risk. Alternatively, an entity may use another method that it considers to faithfully represent the portion of the total change in fair value resulting from a change in instrument-specific credit risk. The entity shall apply the method consistently to each financial liability from period to period.

Question 3.4.10 How are MRBs measured?

Interpretive response: In determining the value at the issuance of the contract, ASU 2018-12 incorporates guidance from Subtopic 815-15 related to identifying the terms of embedded derivatives. The fair value of an MRB as a stand-alone feature is estimated by separating it from the underlying insurance contract. [815-15-25-1]

We believe an entity uses its judgment to determine the appropriate valuation approach based on the specific facts and circumstances of each MRB. Two methods to measure the fair value of the MRB when separated from the underlying insurance contract are the nonoption valuation approach and the option-based valuation approach. [944-40-30-19D]

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Nonoption valuation approach	Option-based valuation approach
• Often called the 'attributed fee' method. • In general, determine MRB terms to achieve a fair value of zero at the contract issue date (often via a calculated attributed fee). • This results in the host contract having the same value as the combined (hybrid) instrument, which is similar to a bond issued at par. • Generally, there is no immediate earnings effect of initial recognition and measurement. • The attributed fee cannot exceed the total contract fees and assessments collectible from the contract holder or be less than zero. Total contract fees are normally set as a percentage, so the attributed fee is as well. • If the contractual fee for the contract feature is more than the attributed fee, the difference can either offset other costs or result in future profit. • Once set at issuance, generally the attributed fee rate does not change over the life of the contract. • Subsequently, the fair value calculation represents the present value of future benefits less the present value of the future attributed fees.	• The MRB terms are not adjusted to achieve a fair value of zero at the contract issue date. • The initial carrying amount of the MRB, as an embedded feature, is deducted from the value of the hybrid contract to obtain the value of the host insurance contract at issuance, resulting in no immediate effect on earnings on initial recognition and measurement. • The host contract is similar to a bond issued at a discount. • Subsequently, the fair value calculation represents the present value of future benefits payable by the MRB feature.

The fair value of an MRB may be positive (an asset) or negative (a liability). [944-40-35-8A]

While an MRB is measured at the individual contract level, certain assumptions may be developed at a higher level. For example, an entity may develop lapse and mortality assumptions for a group of contracts and then apply those to the individual contract. However, total contract fees and assessments collectible from the contract holder are specific to the individual contract. An entity may not use fees and assessments from one contract in the measurement of a different contract. [944-40-30-19D]

For further discussion about measuring contracts with multiple MRBs, see Question 3.4.20.

For further guidance on identifying the terms of an embedded derivative, see KPMG Handbook, Derivatives and hedging.

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Question 3.4.20 How is a contract with multiple MRBs measured?

Interpretive response: When there are multiple contract features in an individual contract, each feature is separately evaluated to determine if it meets the definition of an MRB. If a contract includes multiple MRBs, those benefits are aggregated and measured as a single compound MRB. The fair value of the single compound MRB is determined as a single unit of account. [944-40-30-19D(c)]

The valuation of the single compound MRB follows the guidance in Question 3.4.10. Valuation as a single unit of account could lead to a fair value different from aggregating multiple MRBs if they were valued individually. This difference arises from the interdependencies that may exist between MRBs – as illustrated in the following table for an entity that issues a contract with both a GMWB and a GMDB.

Comparison to legacy US GAAP Legacy US GAAP vs ASU 2018-12

The following table summarizes the key changes from legacy US GAAP when measuring multiple market-based options (a GMWB and a GMDB) and guarantees in an individual contract.

Legacy US GAAP	ASU 2018-12
• Features were valued independently. • The assumptions used to derive the value of the GMWB may have assumed that there was a withdrawal after the payment assumptions that were used to value the GMDB.	• Features are valued as a single compound MRB, which means that all fair value assumptions are considered together. • The valuation considers the interdependencies between the benefits – e.g. the withdrawal assumptions (GMWB) take into account the payment assumptions (GMDB).

Question 3.4.25 What is instrument-specific credit risk included in the measurement of an MRB?

Interpretive response: When an entity measures the fair value of a liability, it includes consideration of instrument-specific credit risk (own credit risk) when determining its nonperformance risk – i.e. the risk that the entity will not fulfill its obligation. Nonperformance risk includes, but may not be limited to, an entity's own credit risk. [944-40-35-8A, 820-20 Glossary]

In considering nonperformance risk in measuring the fair value of an MRB, in addition to own credit risk, an entity considers other factors that might influence the likelihood that the obligation will or will not be fulfilled. [820-10-35-18]

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The fair value measurement is based on the assumptions that market participants would use in pricing the MRB when acting in their economic best interest. An entity assumes that market participants have a reasonable understanding of the rights and obligations inherent in the MRB based on information that would be available to them after customary due diligence. Therefore, it is assumed that the market participant would apply any and all necessary risk adjustments to the price to compensate itself for market, nonperformance (including own credit), liquidity and volatility risks. [820-10-35-54]

For further guidance, see sections D and K of KPMG Handbook, Fair value measurement.

Question 3.4.30 What is the base method for identifying instrument-specific credit risk?

Interpretive response: The only specific method identified in Topic 825 for determining instrument-specific credit risk for financial liabilities for which an entity elects the fair value option is the: [825-10-45-5]

- total change in fair value of a financial liability; less
- changes in fair value of the financial liability arising from a change in a base market risk, such as a risk-free rate or a benchmark interest rate.

Alternatively, an entity can use another method if it results in a fair representation of the total change in fair value resulting from a change in the instrument-specific credit risk. [825-10-45-5]

The method used is a policy election that should be disclosed and consistently applied. We believe a change to this accounting policy represents a change in accounting principle under Topic 250, and an entity should not change the accounting policy unless it is preferable. [250-10-45-2]

For further discussion about consideration of instrument-specific credit risk when the MRB is in an asset position, see Question 3.4.50.

For further guidance, see section 3.3 of KPMG Handbook, Accounting changes and error corrections.

Question 3.4.40 How is the change in instrument-specific credit risk determined?

Interpretive response: The change in the instrument-specific credit risk is the portion of the change in fair value that excludes the amount of the change resulting from a change in the base market rate – e.g. risk-free rate or benchmark interest rate. Alternatively, an entity may use another method to determine the change in the instrument-specific credit risk. The method used is a policy election that should be disclosed and consistently applied. [825-10-45-5]

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Question 3.4.50 Is instrument-specific credit risk considered when the MRB is in an asset position?

Interpretive response: Maybe. When determining the fair value of an MRB, an entity considers instrument-specific credit risk. The entity records changes in the fair value of an MRB attributable to a change in the instrument-specific credit risk in OCI. [944-40-35-8A]

The fair value measurement for a liability includes consideration of instrument-specific credit risk (own credit risk) to determine its nonperformance risk – i.e. the risk that the entity will not fulfill its obligation. [820-20 Glossary]

When the MRB is in an asset position at the end of a reporting period, the fair value measurement may consider that the MRB could be in a liability position in a future scenario. This may result in instrument-specific credit risk impacting the fair value of an MRB in an asset position. If instrument-specific credit risk is included in the fair value measurement of an MRB in an asset position, the change in fair value attributable to a change in the instrument-specific credit risk is recorded in OCI. [944-40-35-8A]

Question 3.4.60 What contract fees and assessments are 'collectible from the contract holder'?

Interpretive response: Total attributed fees used to determine the fair value of an MRB cannot exceed total contract fees and assessments collectible from the contract holder for each individual contract. An entity collects these contract fees and assessments from the contract holder under the terms of the contract. [944-40-30-19C]

An entity may receive fees outside of its contract with the contract holder that are not included in total contract fees and assessments from the contract holder. Examples of these excluded fees include: [944-40-30-19C]

- mutual fund fees (i.e. commissions) from an affiliate mutual fund provider;
- mutual fund fees (i.e. revenue sharing) from a third-party mutual fund relating to the entity's separate account investments; and
- investment spreads on general account products.

Further, we do not believe that surrender charges are included in total contract fees and assessments from the contract holder when measuring the MRB. Although surrender charges are assessments collectible from the contract holder under the terms of the contract, they are not collected to support the contract feature. Instead, they are collected when the contract holder cancels (or partially cancels) the contract and forfeits the benefit provided by the contract feature.

We believe that the terms of the MRB are determined at contract issuance for each individual contract. Therefore, we do not believe that expected fees and assessments collectible from one contract holder can be attributed to a different contract.

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Question 3.4.70 Are expected contract holder's investment option choices for a variable annuity contract considered in measuring an MRB?

Interpretive response: Yes. When measuring an MRB, we believe an entity considers the contract holder's contractual investment option rights and whether those are subject to the guarantee. This includes the contract holder's rights to deposit additional funds and/or re-allocate its funds between different investment options – i.e. general account or separate account options. If those rights are subject to the guarantee, then we believe they are part of the existing contract.

When measuring the MRB, an entity considers its expectation of all contractual cash flows related to the variable annuity contract or contract feature being assessed based on the assumptions that market participants would use. An entity assumes that market participants have a reasonable understanding of the rights and obligations inherent in the MRB based on information that would be available to them after customary due diligence. Therefore, when the variable annuity contract allows the contract holder to deposit additional funds or change its investment options, an entity considers its expectation of the contract holder's investment option choices when measuring the MRB. [820-10-35-54, 944-40-30-19C – 30-19D]

For example, if the variable annuity contract holder has the contractual right to receive the MRB on future funds deposited under the existing contract, then we believe an entity's MRB measurement incorporates a market participant's assumption of expected future funds deposited.

For further guidance about fair value measurement, see sections D and K of KPMG Handbook, Fair value measurement.

Example 3.4.10 MRB – valuation

Life Insurer writes an insurance contract with a GMDB rider that meets the definition of an MRB and is measured at fair value. Life Insurer adopted ASU 2018-12 at the beginning of Policy Year 5 (the transition date).

As illustrated in Example 7.4.10, at transition, Life Insurer:

- used the required retrospective transition method and maximized relevant observable information to determine the 87.2% attributed fee ratio (at contract issuance) to be used to calculate the fair value of the MRB.
- calculated the fair value of the MRB as $90,257.
- recorded the cumulative difference in the instrument-specific credit risk from contract issuance to transition of $1,042 (credit) in AOCI.

The numbers in this example are rounded. In addition, this example assumes no expense fees or maintenance fees.

Life Insurer is preparing its financial statements at the end of Policy Year 5 – i.e. one year after transition.

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Life Insurer uses the following discount rates to measure the MRB under ASU 2018-12.

	Discount rate[1]	Risk-free rate	Own credit spread
At contract issuance	3.00%	2.50%	0.50%
At transition	3.75%	3.00%	0.75%
Current period[2]	4.25%	3.25%	1.00%

Notes:
1. The sum of the risk-free rate and own credit spread.
2. For each of Policy Years 5 to 10.

MRB liability (asset) calculation at end of Policy Year 5

At the end of Year 5, Life Insurer estimates its future cash flow assumptions for all remaining policy years to reflect management's best estimates of projected rider charges and projected excess claims as follows.

Projected rider charges and excess claims		
Policy year	**Rider charges (a)**	**Excess claims (b)**
6	62,000	60,000
7	62,000	68,000
8	62,000	76,000
9	62,000	84,000
10	62,000	92,000

Life Insurer calculates the present value of projected rider charges and the present value of projected excess claims for Policy Years 6 to 10 discounted using the current-period discount rate.

Cash flows	At current-period discount rate (4.25%)
Projected rider charges (sum of entries in column (a) for Policy Years 6 to 10)	274,085
Projected excess claims (sum of entries in column (b) for Policy Years 6 to 10)	333,034

Life Insurer uses the calculated present value of projected cash flows (at the current-period discount rate) and the locked-in attributed fee ratio (calculated at contract issuance) to calculate the MRB at the end of Policy Year 5 of $94,032 [$333,034 – (87.2% × $274,085)] as follows.



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Change in instrument-specific credit risk calculation

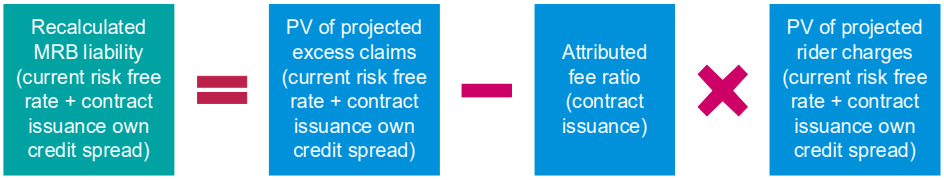
Life Insurer calculates the present value of projected rider charges and the present value of projected excess claims for Policy Years 6 to 10 discounted using the current risk-free rate + the contract issuance own credit spread (instrument-specific credit risk). Life Insurer uses the current risk-free rate to isolate the portion of the change in fair value that is not due to changes in the risk-free rate.

Cash flows	At a discount rate of 3.75%[1]
Projected rider charges (sum of entries in column A for Policy Years 6 to 10)	277,962
Projected excess claims (sum of entries in column B for Policy Years 6 to 10)	338,089

Note:

1. The sum of the current risk-free rate (3.25%) + the contract issuance own credit spread (0.50%).

Life Insurer uses these projected cash flows and the locked-in attributed fee ratio (calculated at contract issuance) to recalculate the MRB. This recalculated MRB will be used to determine the change in the own credit spread (instrument-specific credit risk) from contract issuance to the end of Policy Year 5. The recalculated MRB is $95,706 [$338,089 – (87.2% × $277,962)].



At the end of Policy Year 5, the cumulative difference in the MRB because of the change in the instrument-specific credit risk since contract issuance is ($1,674) [$94,032 – $95,706].

Calculation of financial statement amounts

At the end of Policy Year 5, Life Insurer calculates the amounts to be recorded in the financial statements.

Change in own credit risk (AOCI)	
Change in own credit risk from contract issuance through end of Policy Year 5	(1,674)
Less: Change in own credit risk recorded in AOCI at transition (beginning of Policy Year 5)	(1,042)
Current-period change in own credit risk (change in AOCI during Policy Year 5) ($1,674 – $1,042)	(632)

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Change in MRB	
MRB liability at end of Policy Year 5 (using the current-period discount rate)	94,032
Less: MRB liability at transition (beginning of Policy Year 5) (using the transition discount rate of 3.75%)	90,257
Change in MRB liability during Policy Year 5 ($94,032 – $90,257)	3,775

At the end of Policy Year 5, Life Insurer records the following journal entry.

	Debit	Credit
Change in MRB (Income statement)[1]	4,407	
AOCI		632
MRB liability		3,775
To record change in liability balance during Policy Year 5 with change in own credit risk recorded in AOCI.		

Note:
1. $632 + $3,775.

FASB Example

The following FASB example illustrates the accounting for MRBs related to guaranteed minimum accumulation or death benefit and guaranteed minimum living benefits.

Excerpt from ASC 944-40

Long-Duration Contracts

> Illustrations

• > Example 2: Market Risk Benefits

• • > Guaranteed Minimum Accumulation or Death Benefit

55-29A A contract holder deposits $100,000 in a deferred annuity (either fixed or variable) that provides for a **guaranteed minimum accumulation benefit** that guarantees that at a specified anniversary date (for example, 5 years) the contract holder's account balance will be the greater of the following:

a. The account value
b. Deposits less partial withdrawals accumulated at 3 percent interest compounded annually.

55-29B The contract holder's account balance is exposed to stock market performance. At the specified anniversary date the contract holder's account balance has declined to $80,000 due to stock market declines. The guaranteed minimum value of the $100,000 deposit compounded annually at 3 percent interest is $115,930. The contract holder's account balance will be increased to

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the greater amount, resulting in an account balance of $115,930. In this Example, the guaranteed minimum accumulation benefit meets the criteria for a market risk benefit in accordance with paragraph 944-40-25-25C because the guaranteed minimum accumulation benefit protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk. Specifically, the insurance entity compensates the contract holder for the shortfall (due to stock market declines) between the account balance amount of $80,000 and the guaranteed amount of $115,930. The guaranteed minimum accumulation benefit should be measured at fair value in accordance with paragraph 944-40-30-19C. Similarly, if on the date of the death of the contract holder the deferred annuity provides a guaranteed minimum death benefit amount of $115,930 while the account balance is $80,000, the guaranteed minimum death benefit meets the criteria for a market risk benefit in accordance with paragraph 944-40-25-25C because the insurance entity provides compensation for the shortfall (due to stock market declines) between the account balance amount of $80,000 and the guaranteed amount of $115,930.

• • > Guaranteed Minimum Living Benefits

55-29C A contract holder deposits $100,000 in a deferred annuity (either fixed or variable) that provides a **guaranteed minimum income benefit**. The contract specifies that if the contract holder elects to annuitize, the amount available to annuitize will be the higher of the then account balance or the sum of deposits less withdrawals. The contract holder's account balance is exposed to stock market performance. At the date that the contract holder chooses to annuitize, the account balance has declined to $80,000 due to stock market declines.

55-29D In this Example, the guaranteed minimum income benefit meets the criteria for a market risk benefit in accordance with paragraph 944-40-25-25C because the guaranteed minimum income benefit protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk. Specifically, the insurance entity compensates the contract holder for the shortfall (due to stock market declines) between the account balance amount of $80,000 and the $100,000 guaranteed amount at the **annuitization** date. During the **accumulation phase**, the guaranteed minimum income benefit feature should be measured at fair value in accordance with paragraph 944-40-30-19C. Similarly, if the deferred annuity provides a **guaranteed minimum withdrawal benefit** or a guaranteed minimum lifetime withdrawal benefit that protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk, the guaranteed minimum withdrawal benefit or the guaranteed minimum lifetime withdrawal benefit meets the criteria for a market risk benefit.

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3.5 Derecognition

Excerpt from ASC 944-40

Long-Duration Contracts

> Universal Life-Type Contracts and Nontraditional Contract Benefits

• > Additional Liability

• • > Market Risk Benefits

35-8B Upon derecognition of a market risk benefit, an insurance entity shall derecognize any related amount included in accumulated other comprehensive income. An insurance entity only shall include in net income any gain or loss that is realized as a result of the insurance entity's nonperformance (that is, the settlement or extinguishment of an obligation for an amount less than the contractual obligation amount). On the date of **annuitization** (for annuitization benefits) or upon extinguishment of the account balance (for withdrawal benefits) the balance related to the market risk benefit shall be derecognized, and the amount deducted (after derecognition of any related amount included in accumulated other comprehensive income) shall be used in the calculation of the liability for future policy benefits for the payout annuity (including the establishment of a deferred profit liability to the extent that the market risk benefit amount deducted exceeds the amount of the liability for future policy benefits or the recognition of an immediate loss to the extent that the amount of the liability for future policy benefits exceeds the market risk benefit amount deducted).

Question 3.5.10 What is the accounting for MRBs upon derecognition?

Interpretive response: An MRB is derecognized in the financial statements upon annuitization (for annuitization benefits) or upon extinguishment of the account balance (for withdrawal benefits).

For contracts with an annuitization option, from an accounting perspective, the: [944-40-35-8B]

- date of annuitization represents the end of the initial contract; and
- payout phase represents a new contract.

For contracts with a GMWB, from an accounting perspective, the:

- date the host contract's account balance reaches zero represents the end of the initial contract; and
- the payout phase (future GMWB payments) represents a new contract.

For both types of contracts, the MRB is derecognized at the end of the initial accounting contract. This is also the issue date of a new distinct accounting contract representing the payout phase of the underlying contract.

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At this time, an entity first derecognizes any amounts previously recorded in AOCI for instrument-specific credit risk. Derecognized AOCI amounts are recorded as a gain (loss) in earnings if they result from an entity's nonperformance – i.e. settlement for less than the contractual obligation. Any remaining AOCI amounts are derecognized through the MRB.

The entity then derecognizes the MRB: [944-40-35-8B]

- through the income statement if it has settled the obligation – e.g. for a GMAB the entity records a gain or loss in the current period representing the difference between the settled obligation (cash withdrawal amount) and the MRB +/- any derecognized AOCI unrelated to nonperformance recorded; or
- by establishing a payout annuity, with the MRB and the contract holder's previous account balance considered the premium paid for the payout annuity.

Reinsured contracts with annuitization benefits

For contracts with an MRB that have an annuitization option and for contracts with a GMWB, at the issue date of the new distinct accounting contract, an entity establishes a liability for future policy benefits for the payout annuity using the net premium model. First, an entity calculates the amount of the derecognized contract as:

The contract holder's account balance for the deferred annuity, if any

+/– the MRB, at fair value

+/– any derecognized AOCI unrelated to nonperformance

If the calculated amount of the derecognized contract is: [944-40-35-8B]

- less than the liability for future policy benefits established for the payout annuity, using the net premium model, a loss is recorded in earnings for the difference; or
- greater than the liability for future policy benefits established for the payout annuity using the net premium model, a deferred profit liability is recorded for the difference.

Example 3.5.10 illustrates the accounting for a deferred annuity contract with an annuitization option.

Example 3.5.10 MRB accounting at annuitization

Life Insurer writes a deferred annuity contract with a GMDB rider. The GMDB rider meets the definition of an MRB and is measured at fair value. At the annuitization date:

- the contract holder's account balance for the deferred annuity is $80
- the fair value of the MRB liability is $16
- the AOCI balance for the change in the MRBs instrument-specific credit risk since issuance (credit) is $4.

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Scenario 1: Derecognized liability greater than payout annuity liability

Upon annuitization, Life Insurer calculates a liability for future policy benefits (payout annuity) of $88 using the net premium model.

Life Insurer concludes that the amount previously recorded in AOCI is not due to nonperformance because it met its contractual obligation to establish the payout annuity. Therefore, Life Insurer derecognizes the amounts recorded in AOCI for instrument-specific credit risk through the MRB. This effectively increases the MRB for the derecognized unrealized instrument-specific credit risk previously recorded in AOCI.

Life Insurer records the following journal entry.

	Debit	Credit
AOCI	4	
MRB liability		4
To derecognize unrealized instrument-specific credit risk amounts recorded in AOCI.		

Life Insurer derecognizes the MRB and the contract holder's account balance for the deferred annuity and records a liability for future policy benefits for the payout annuity. The MRB and the contract holder's account balance for the deferred annuity are considered the premium paid for the payout annuity.

Because the derecognized liabilities are greater than the liability for future policy benefits for the payout annuity, Life Insurer also records a deferred profit liability for the excess – i.e. Life Insurer follows the limited-payment contract guidance for a single-premium payout annuity.

Life Insurer records the following journal entry.

	Debit	Credit
Contract holder's account balance (deferred annuity)	80	
MRB liability[1]	20	
Liability for future policy benefits (payout annuity)		88
Deferred profit liability[2]		12
To derecognize the contract holder's account balance for the deferred annuity and record the liability for future policy benefits – payout annuity and the related deferred profit liability.		

Notes:

1. $16 + $4.
2. ($80 + $20) – $88.

Scenario 2: Derecognized liability less than payout annuity liability

Upon annuitization, Life Insurer calculates a liability for future policy benefits (payout annuity) of $102 using the net premium model.

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Life Insurer concludes that the amount previously recorded in AOCI is not due to nonperformance because it met its contractual obligation to establish the payout annuity. Therefore, Life Insurer derecognizes the amounts recorded in AOCI for instrument-specific credit risk through the MRB. This effectively increases the MRB for the derecognized unrealized instrument-specific credit risk previously recorded in AOCI.

Life Insurer records the following journal entry.

	Debit	Credit
AOCI	4	
MRB liability		4
To derecognize the unrealized instrument-specific credit risk amounts recorded in AOCI		

Life Insurer derecognizes the MRB and the contract holder's account balance for the deferred annuity and records a liability for future policy benefits for the payout annuity. The MRB and the contract holder's account balance for the deferred annuity are considered the premium paid for the payout annuity. Because the derecognized liabilities are less than the liability for future policy benefits for the payout annuity, there is insufficient 'in substance' premium received for the payout annuity. As such, Life Insurer records an immediate loss through earnings for the difference.

Life Insurer records the following journal entry.

	Debit	Credit
Contract holder's account balance (deferred annuity)	80	
MRB liability[1]	20	
Loss[2]	2	
Liability for future policy benefits (payout annuity)		102
To derecognize the contract holder's account balance (deferred annuity), record the liability for future policy benefits (payout annuity) and record the loss.		

Notes:
1. $16 + $4.
2. $102 – ($80 + $20).

3.6 Reinsurance

An MRB can also exist in a reinsurance arrangement. A reinsurer may assume all or a portion of an MRB. Both the ceding entity and the assuming reinsurer follow the MRB guidance in ASU 2018-12, including the prescribed ordering to determine the appropriate accounting treatment for the contract or contract feature. [944-40-25-40]

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Excerpt from ASC 944-40

Reinsurance Contracts

25-40 A reinsurer may agree to reinsure all or a portion of certain **annuitization** or death or other insurance benefits (see paragraphs 944-40-25-25B through 25-27A). Both the **ceding entity** and the reinsurer shall first determine whether such a reinsurance contract should be accounted for under the **market risk benefit** provisions of paragraph 944-40-25-25C. For reinsurers, the reference to the account balance in paragraph 944-40-25-25D refers to the underlying contract between the direct writer and the contract holder. If the reinsurance contract is not accounted for under the market risk benefit provisions of paragraph 944-40-25-25C, both the ceding entity and the reinsurer shall then determine whether such a reinsurance contract should be accounted for under the provisions of Subtopic 815-10 or 815-15.

25-41 If the reinsurance contract is not required to be accounted for under the provisions of paragraph 944-40-25-25C or Subtopic 815-10 or 815-15, the entity shall apply the guidance in paragraphs 944-40-25-26 through 25-27A.

Question 3.6.10 What order does a reinsurer use to determine the accounting method for contracts or contract features that include benefits in addition to the account balance?

Interpretive response: When a reinsurance contract includes benefits in addition to the account balance, a reinsurer first assesses whether the contract contains significant morbidity or mortality risk to determine whether it is to be accounted for as an insurance contract, as opposed to an investment contract. Then, a reinsurer follows the same order as a direct writer to determine the appropriate accounting method for each individual contract or contract feature (see Question 3.3.40). [944-40-25-40 – 25-41]

Question 3.6.20 Can credit risk result in a valuation difference between a direct MRB liability and the related reinsurance recoverable?

Interpretive response: Yes. For the ceding entity, the MRB liability and the related reinsurance recoverable are separately measured because they consider the credit risk of different legal parties.

The valuation of a direct MRB liability includes consideration of instrument-specific credit risk of the entity (own credit risk). The valuation of the related reinsurance recoverable considers the default risk of the reinsurer. The result is that the fair value of the direct MRB liability is generally different from the fair value of the related reinsurance recoverable.

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The change in the fair value of an MRB attributable to instrument-specific credit risk is recorded in AOCI. The change in the fair value of the reinsurance recoverable, which includes the change in the default risk of the reinsurer, is recorded in the income statement. This may result in a difference between the amounts recorded in income for the change in the fair value of an MRB liability and the change in the related reinsurance recoverable. [944-40-35-8A]

Question 3.6.30 Can a reinsurer record a gain or loss at inception of a reinsurance agreement when assuming only the MRB feature of an insurance contract?

Interpretive response: No. When a reinsurance agreement is entered into by independent market participants and assumes only the MRB feature of an insurance (direct) contract – e.g. it exclusively reinsures the direct contract's MRB feature – the purchase price paid reflects the fair value. As such, in this scenario, we do not believe that either party recognizes a gain or loss (i.e. cost of reinsurance) upon entering the reinsurance agreement because the terms were agreed to in an orderly transaction between market participants. Similar to direct contracts, the MRB feature of an insurance contract assumed via reinsurance is accounted for at fair value. [944-40-25-40 – 25-41, 820-20 Glossary, 815-15-25-1]

For discussion about the order used to determine the accounting method by a reinsurer, see Question 3.3.40.

Question 3.6.40 How does a reinsurer measure a reinsurance contract with multiple MRBs?

Interpretive response: A reinsurer follows the same guidance as a direct writer when measuring a contract with multiple MRBs. If a contract contains multiple MRBs, those benefits are aggregated and measured as a single compound MRB. The fair value of the single compound MRB is determined as a single unit of account. [944-40-30-19D(c)]

For discussion about measuring direct insurance contracts with multiple MRBs, see Question 3.4.20.

Question 3.6.50 What is the accounting for reinsured MRBs upon derecognition?

Interpretive response: An entity may cede all or a portion of its MRBs. The reinsured MRB is derecognized in the financial statements at the end of the initial accounting contract. For reinsured contracts with withdrawal benefits, the MRB is derecognized upon extinguishment of the account balance. For reinsured contracts with annuitization benefits, the MRB is derecognized upon annuitization because, from an accounting perspective, the date of annuitization represents the end of the initial contract. [944-40-35-8B]

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At this time, an entity derecognizes the MRB: [944-40-35-8B, 944-40-25-34]

- through the income statement if it has settled the obligation – e.g. for a GMAB the entity records a gain or loss in the current period representing the difference between the settled obligation (cash withdrawal amount) and the MRB, which includes the counterparty credit risk of the reinsurer; or
- by establishing a payout annuity, with the MRB and the contract holder's previous account balance considered the premium paid for the payout annuity.

The entity calculates the amount of the derecognized contract as the contract holder's previous account balance for the deferred annuity, if any, +/- the MRB, at fair value. This calculated amount includes the portion of the MRB balance related to counterparty credit risk. [944-40-35-8B]

Reinsured contracts with annuitization benefits

For reinsured contracts with annuitization benefits, the MRB derecognition date is also the issue date of a new distinct accounting contract representing the payout phase of the reinsured underlying contract. A reinsurance recoverable is established for the reinsured payout annuities using the net premium model and assumptions that are consistent with those used to estimate the liabilities of the underlying reinsured contracts.

The accounting depends on whether the calculated amount of the derecognized contract is greater or less than the reinsurance recoverable established for the payout annuity. [944-40-35-8B; 944-605-30-4]

- **Less than:** Using the net premium model, we believe that a gain can be recorded to the extent that there are offsetting direct losses incurred on the derecognition of the direct MRBs. We believe that any incremental reinsured gains are deferred as cost of reinsurance and amortized using assumptions consistent with those used in estimating the reinsurance recoverable.
- **Greater than:** Using the net premium model, a cost of reinsurance is recorded for the difference between the calculated amount of the derecognized contract and the reinsurance recoverable established for the payout annuity. This amount is amortized using assumptions consistent with those used in estimating the reinsurance recoverable.

For further discussion around the accounting for MRBs upon derecognition, see Question 3.5.10.

Example 3.5.10 illustrates the accounting for a deferred annuity contract with an annuitization option.

Observation Ceded MRBs

ASU 2018-12 requires a full retrospective adoption method for MRBs. Because direct insurance contracts and ceded reinsurance contracts are separate units of account, the individual terms of each contract are accounted for separately.

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Financial reporting differences may exist between the separate units of account because of these individual terms – e.g. different issue dates resulting in unique discount rates at issuance and evaluation of own credit risk versus counterparty credit risk. Entities will need to consider these differences when determining how to explain their financial results. [944-40-65-2(f)]

3.7 Presentation

Excerpt from ASC 944-40

Long-Duration Contracts

> Universal Life-Type Contracts and Nontraditional Contract Benefits

• > Market Risk Benefits

45-3 The carrying amount of **market risk benefits** shall be presented separately in the statement of financial position. The change in **fair value** related to market risk benefits shall be presented separately in net income, except fair value changes attributable to a change in the instrument-specific credit risk of market risk benefits in a liability position. The portion of a fair value change attributable to a change in the instrument-specific credit risk of market risk benefits in a liability position shall be presented separately in other comprehensive income.

An entity is required to separately present on the face of the balance sheet the carrying amount of the MRB liabilities and assets because there is no legal right of offset between the contracts. [944-40-45-3]

Question 3.7.10 Where are changes in fair value recorded?

Interpretive response: The following table describes where the components of the changes in fair value of MRBs are recorded in the financial statements. [944-40-35-8A]

Net income	OCI
Changes in fair value, except for changes attributable to the instrument-specific credit risk of MRBs.	Changes in fair value attributable to the instrument-specific credit risk of MRBs.

Question 3.7.20 Can direct and reinsured MRBs be presented net in the financial statements?

Interpretive response: No. An entity is required to separately present on the balance sheet the carrying amount of the MRB assets and liabilities because

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there is no legal right of offset between the contracts. Similarly, we do not believe an entity can present the carrying amount of its direct MRBs net of any related reinsurance recoverable for its reinsured MRBs on the balance sheet because there is no legal right of offset between the contracts. Further, an entity records changes in fair value of reinsured MRBs consistent with the change in the direct MRB. See Question 3.7.10. [944-40-45-3]

For guidance on disclosing reinsurance, see Questions 6.3.10, 6.3.20, and 6.5.120.

Observation OCI presentation

Recognizing the changes in fair value for instrument-specific credit risk in OCI is consistent with recognizing the change in credit risk in OCI when the fair value option is elected for a liability under Topic 825. [ASU 2018-12.BC78]

3.8 Transition

ASU 2018-12 requires measuring MRBs at fair value at the transition date using a full retrospective adoption method for all periods presented. Further consideration and guidance is discussed in section 7.4. [944-40-65-2(f)]

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4. Deferred acquisition costs

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Question 4.8.30 Has the accounting for the cost of reinsurance changed?

Question 4.8.40 How does an entity account for ceding commission received that represents the recovery of acquisition costs?

Question 4.8.50 Can an entity group contracts assumed in a reinsurance agreement for DAC amortization?

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4.1 How the standard works

ASU 2018-12 provides a simplified amortization method for DAC for long-duration contracts. Legacy US GAAP had multiple amortization methods for DAC that could be complex. ASU 2018-12 amends legacy US GAAP to require amortization over the expected term of the related contracts on a constant level basis unrelated to revenue or profit emergence for long-duration contracts that historically amortized DAC in proportion to premiums, gross profits or gross margins.

Comparison to legacy US GAAP Legacy US GAAP vs ASU 2018-12

The following table summarizes the key changes from legacy US GAAP for DAC.

Legacy US GAAP	ASU 2018-12
Defined the criteria for capitalizing acquisition costs.	No change to the criteria for capitalizing acquisition costs, but clarifies costs that should be expensed as incurred.
Various amortization models were used and were linked to revenue or profit of the related insurance contracts – e.g. premiums, gross profits or gross margins.	Constant level basis amortization (on an individual contract or grouped contract basis) over the expected term of the related contracts using assumptions consistent with the liability for future policy benefits (or any other related balance).
Interest accrued on the unamortized balance of DAC at the rate used to discount expected gross profits.	No accrual of interest on the unamortized balance of DAC.
Adjustments were made for the effect of investment performance or changes in expected future liability cash flows (shadow adjustments).	No shadow adjustments because unrealized investment gains and losses are not considered in amortizing DAC.
Evaluated for impairment.	Write down for unexpected contract terminations, but not subject to an impairment test.
Deferred sales inducements were amortized using the same methodology and assumptions used to amortize DAC.	Deferred sales inducements are amortized using the same methodology and assumptions used to amortize DAC, but clarifies amortization excludes future sales inducements before they are incurred and capitalized.
DAC for certain investment contracts was amortized using the effective interest method.	No change. DAC for certain investment contracts continues to be amortized using the effective interest method.

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4.2 Applicability

The simplified DAC amortization guidance in ASU 2018-12 generally applies to long-duration contracts whether or not ASU 2018-12 modified the measurement of the liability for the related contract.

The following table details those contracts or entities included and excluded from the scope of the amended DAC guidance.

Included in scope	Excluded from scope
• Traditional fixed and variable annuity contracts • Life insurance contracts • Limited-payment contracts • Universal life-type contracts • Nontraditional fixed and variable annuity and life insurance contracts • Participating life insurance contracts • Group participating pension contracts [944-20-05-14]	• Investment contracts that do not include significant surrender charges or that do not yield significant revenues from sources other than the investment of contract holders' funds are amortized consistent with the effective interest method in Subtopic 310-20 [944-30-35-19 – 35-20] • Financial guarantee contracts [944-20-05-44] • Mortgage guaranty insurance entities [944-30-15-2]

4.3 Capitalized acquisition costs

Insurance entities incur costs when issuing or renewing insurance contracts.

Under legacy US GAAP, costs that were incremental and directly related to the successful acquisition of new or renewal insurance contracts were deferred. Generally, these costs included nonrecurring agent or broker commissions, premium taxes, medical and inspection fees and other costs related to policy issuance and underwriting. [944-30-25-1A – 25-1AA, ASU 2018-12.BC79]

Further, maintenance costs related to universal-life-type contracts and certain long-duration participating life insurance contracts were expensed as incurred, including those that: [944-30-25-4 – 25-5]

- varied in a constant relationship to premiums or to insurance in force – e.g. premium taxes;
- were recurring in nature; or
- tended to be incurred in a level amount from period to period – e.g. recurring premium taxes and ultimate level commissions.

ASU 2018-12 does not change the criteria for capitalizing acquisition costs. However, it expands the maintenance cost guidance for universal life-type contracts and certain long-duration participating life insurance contracts to all long-duration contracts. Additionally, it clarifies that acquisition costs, including future contract costs, are not capitalized or amortized before the costs are actually incurred. [944-30-25-4 – 25-5, 30-2]

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Excerpt from ASC 944-30

General

25-1A An insurance entity shall capitalize only the following as acquisition costs related directly to the successful acquisition of new or renewal insurance contracts:

a. **Incremental direct costs of contract acquisition**
b. The portion of the employee's total compensation (excluding any compensation that is capitalized as incremental direct costs of contract acquisition) and payroll-related fringe benefits related directly to time spent performing any of the following acquisition activities for a contract that actually has been acquired:
    1. Underwriting
    2. Policy issuance and processing
    3. Medical and inspection
    4. Sales force contract selling.
c. Other costs related directly to the insurer's acquisition activities in (b) that would not have been incurred by the insurance entity had the acquisition contract transaction(s) not occurred.

25-1AA The costs of direct-response advertising shall be capitalized if both of the following conditions are met:

a. The primary purpose of the advertising is to elicit sales to customers who could be shown to have responded specifically to the advertising. Paragraph 944-30-25-1D discusses the conditions that must exist in order to conclude that the advertising's purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising.
b. The direct-response advertising results in probable future benefits. Paragraph 944-30-25-1G discusses the conditions that must exists in order to conclude the direct-response advertising results in probable future benefits.

Long-Duration Contracts

> Universal Life-Type Contracts

25-3 This guidance does not define the costs to be included in **acquisition costs** but does describe those that are not eligible to be capitalized.

25-4 Acquisition costs that have any of the following characteristics shall be considered maintenance and other period costs and be charged to expense in the period incurred:

a. Acquisition costs that vary in a constant relationship to premiums or insurance in force
b. Acquisition costs that are recurring in nature
c. Acquisition costs that tend to be incurred in a level amount from period to period.

25-5 Costs such as recurring premium taxes and ultimate level commissions, which vary with premium revenue, shall be charged to expense in the periods incurred.

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> Limited-Payment Contracts

25-8 Costs related to the acquisition of new and renewal business that are not capitalized (because they do not meet the criteria for capitalization in paragraphs 944-30-25-1A through 25-1AA) and costs that are required to be charged to expense as incurred, such as those relating to investments, general administration, policy **maintenance costs**, product development, market research, and general overhead (see paragraphs 944-40-30-15 and 944-720-25-2) are period costs that shall be recognized when incurred. Such costs shall not be included in the calculation of **net premium** used in determining the profit to be deferred on **limited-payment contracts** because the inclusion of such costs in the calculation of net premium would result in their deferral.

25-9 Costs that would be included in the determination of net premium under this Subtopic are policy-related costs that are not primarily related to the acquisition of business (such as termination or settlement costs; see paragraph 944-40-30-15).

30-2 Incurred **acquisition costs** for long-duration contracts shall be used in determining acquisition costs to be capitalized. Acquisition costs, including future contract renewal costs, shall not be capitalized or amortized before the incurrence of those costs.

Question 4.3.10 Does the definition of acquisition costs change?

Interpretive response: No. Under legacy US GAAP, acquisition costs were defined as costs that are related directly to the successful acquisition of a new or renewal insurance contract. ASU 2018-12 does not change that definition. [944-20 Glossary, 944-30-25-1A – 25-1AA]

Question 4.3.20 Have the types of acquisition costs to be capitalized changed?

Interpretive response: Yes. While ASU 2018-12 does not change the definition of acquisition costs, it does clarify:

- costs that are not eligible to be capitalized and should be expensed as incurred; and
- that acquisition costs, including future contract costs, are not capitalized or amortized before the costs are actually incurred.

ASU 2018-12 modifies the guidance for capitalization of acquisition costs for insurance contracts other than universal life-type contracts. An entity applies the guidance that was previously only applied to universal life-type contracts to all long-duration contracts. [944-30-25-3 – 25-5]

Acquisition costs that meet the following criteria are period costs that are expensed when incurred: [944-30-25-4]

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- vary in a constant relationship to premiums or insurance in force – e.g. premium taxes;
- recurring in nature; and
- tend to be incurred in a level amount from period to period – e.g. recurring premium taxes and ultimate level commissions

For some entities, this clarification may change whether acquisition costs are capitalized for long-duration insurance contracts.

Question 4.3.30 Is there a change in the calculation of the net premium used to determine the deferred profit on limited-payment contracts?

Interpretive response: Yes. Under legacy US GAAP, costs that did not meet the criteria for capitalization in paragraphs 944-30-25-1A to 25-1AA were expensed when incurred. Therefore, those costs were not included in the calculation of net premium used to determine the profit to be deferred on limited-payment contracts. ASU 2018-12 does not change that guidance.

However, ASU 2018-12 clarifies that the following costs are also period costs to be expensed as incurred: costs related to investments, general administration, policy maintenance costs, product development, market research and general overhead. These costs are not included in the calculation of net premium used in determining the profit to be deferred on limited-payment contracts. [944-30-25-8]

Costs that are included in determining net premium for limited-payment contracts are contract-related costs that are not primarily related to the acquisition of the business, such as termination or settlement costs. [944-30-25-8 – 25-9]

Question 4.3.40 Is there a change in acquisition costs subject to capitalization for certain participating life insurance contracts?

Interpretive response: No. ASU 2018-12 removes the specific guidance for certain participating life insurance contracts previously included in paragraph 944-30-25-10. However, similar guidance exists in paragraph 944-30-25-4 that is now applicable to all long-duration contracts, including certain participating life insurance contracts. [944-30-25-4]

4.4 Amortization of capitalized acquisition costs

4.4.10 Overview

Under legacy US GAAP, DAC was amortized using amortization methods linked to revenue or profit of the related insurance contracts – e.g. premiums, gross profits or gross margins. Many of these methods were complex, required many

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inputs and assumptions, and created inconsistencies in financial reporting between entities.

ASU 2018-12 significantly modifies the amortization guidance. Capitalized acquisition costs are charged to expense on a constant level basis on an individual contract or grouped contract basis over the expected term of the related contract(s). Amortization of capitalized acquisition costs is no longer linked to recognition of revenue, gross profits or gross margins. [944-30-35-3 – 35-3C]

Under ASU 2018-12, DAC is viewed similar to costs incurred in other industries that are amortized over the length of the underlying contract without accruing interest. They are similar because they represent historical cash flows with no associated future cash flows. [ASU 2018-12.BC88]

The FASB believes that these changes simplify the amortization of DAC by reducing the complexity of amortization models and inconsistencies in financial reporting between entities. This simplified amortization guidance also applies to other balances required to be amortized on a basis consistent with DAC, including the unearned revenue reserve for universal life-type contracts. [ASU 2018-12.BC83]

Excerpt from ASC 944-30

Long-Duration Contracts

> Insurance Contracts

35-3 Capitalized **acquisition costs** shall be charged to expense using assumptions consistent with those used in estimating the **liability for future policy benefits** (or any other related balance) for the corresponding contracts (see Subtopic 944-40), as applicable (for example, **terminations**). For contracts with accumulation and payout phases, the **payout phase** shall be viewed as a separate contract under this Topic and shall not be combined with the **accumulation phase** for amortization of capitalized acquisition costs.

35-3A Acquisition costs capitalized under paragraphs 944-30-25-1A through 25-1AA shall be charged to expense on a constant level basis—either on an individual contract basis or on a grouped contract basis—over the expected term of the related contract(s) as follows:

a. Individual contracts. Capitalized acquisition costs shall be charged to expense on a straight-line basis.
b. Grouped contracts. Capitalized acquisition costs shall be charged to expense on a constant level basis that approximates straight-line amortization on an individual contract basis. Contracts shall be grouped consistent with the grouping used in estimating the liability for future policy benefits (or any other related balance) for the corresponding contracts.

The resulting amortization amount shall not be a function of revenue or profit emergence. The amortization method shall be applied consistently over the expected term of the related contract(s).

35-3B The balance of capitalized acquisition costs shall be reduced for actual experience in excess of expected experience (that is, as a result of unexpected contract terminations). The effect of changes in future estimates (for example,

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revisions of mortality or lapse assumptions as required in paragraph 944-40-35-5(a)) shall be recognized over the remaining expected contract term as a revision of the future amortization amounts.

35-3C No interest shall accrue on the unamortized balance of capitalized acquisition costs. In determining amortization expense, future deferrable costs shall not be included before the incurrence and capitalization of those costs.

> Investment Contracts

35-19 The amortization method described in paragraphs 944-30-35-3 through 35-3C shall be used to amortize acquisition costs deferred under paragraphs 944-30-25-1A through 25-1AA for **investment contracts** that include significant **surrender charges** or that yield significant revenues from sources other than the investment of contract holders' funds.

35-20 Acquisition costs deferred under paragraphs 944-30-25-1A through 25-1AA for other investment contracts shall be amortized using an accounting method that recognizes costs as expenses at a constant rate applied to net policy liabilities and that is consistent with the **interest method** under Subtopic 310-20. The incidence of surrenders (if they are **probable** and can be reasonably estimated) can be anticipated for purposes of determining the amortization period. The rate of amortization shall be adjusted for changes in the incidence of surrenders to be consistent with the handling of principal prepayments under Subtopic 310-20.

Observation Challenges to the simplified amortization method

Entities will need to determine a systematic process to recognize capitalized acquisition costs in the financial statements. This determination should include considering whether updates are needed to the entity's processes and internal controls to amortize DAC on a constant level basis over the expected term, or if new financial data is needed to support the assumptions used. Entities need to consider the resulting systematic process when planning the financial reporting timeline.

4.4.20 Method of amortization

Under ASU 2018-12, capitalized acquisition costs are amortized on a constant level basis over the expected term for either an individual contract or a group of contracts. In addition, this guidance: [944-30-35-3A]

- applies to other balances where consistent amortization is required by Subtopic 944-30, including the unearned revenue reserve for universal life-type contracts; and
- is optional for other balances where consistent amortization results from an accounting policy election – e.g. VOBA and PVFP (see section 5.2).

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For an individual contract, amortization expense is recognized on a straight-line basis over the expected term. For grouped contracts, the constant level basis amortization expense should approximate a pattern of straight-line amortization on an individual contract basis. Constant level basis amortization for grouped contracts will not result in the same amount of amortization recognized each period as straight-line basis amortization for an individual contract. [944-30-35-3A]

Further, the timing of the required reduction of the unamortized balance for unexpected contract terminations is generally expected to result in differences between the two bases. Therefore, the amount of amortization recognized when contracts are grouped will differ from the amortization calculated on an individual contract basis; however, the amortization patterns should be consistent. [944-30-35-3A(b)]

The selected amortization method is required to be applied consistently over the expected term of the related contract(s). [944-30-35-3A]

This change separates the amortization of capitalized acquisition costs from the measurement of the liability for future policy benefits and from the recognition of the related revenue, gross profit or gross margin. [944-30-35-3A]

Question 4.4.10 Is the grouping of contracts for DAC amortization required if the liability for future policy benefits is calculated using grouped contracts?

Interpretive response: No. An entity's decision to amortize capitalized acquisition costs at an individual contract level is not linked to whether contract grouping is used to measure the liability for future policy benefits (or other related balances). Therefore, even though contracts are grouped to calculate the liability for future policy benefits, an entity can elect to amortize DAC on an individual contract basis. [944-30-35-3A(b)]

DAC amortized on an individual contract level basis will need to be aggregated to meet disclosure requirements. This aggregation should be consistent with the disaggregation of the related liability disclosures. For further discussion on disclosures, see chapter 6. [944-30-50-2B(a)]

Question 4.4.15 Must the selected amortization method be applied for all contracts subject to ASU 2018-12?

Interpretive response: No. An entity amortizes DAC on a constant level basis over the expected term for either an individual contract or a group of contracts. We believe an entity may use different amortization methods for individual products (or another grouping level). Once selected, the amortization method should be consistently applied over the expected term of those contracts. [944-30-35-3A]

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Question 4.4.20 If contracts are grouped to amortize DAC, can the grouping differ from the grouping used to calculate the liability for future policy benefits?

Interpretive response: No. If an entity elects to group contracts to amortize capitalized acquisition costs, those groups should be consistent with the groups used to estimate the liability for future policy benefits (or any other related balances) for those same contracts. [944-30-35-3A(b)]

Question 4.4.30 What is considered in determining the expected contract term?

Interpretive response: Under ASU 2018-12, the insurance contract's expected term is the amortization period for capitalized acquisition costs. [944-30-35-3A]

ASU 2018-12 does not define 'expected term'. We believe it is the duration that includes all expected cash flows under the contract, including expected future cash flow payments for claims incurred, taking into consideration assumptions about expected termination, mortality and benefit features. For example, for a long-term care or disability contract, the expected contract term includes both the premium paying period (cash inflows) and the claims settlement period (cash outflows). For further discussion about the expected cash flows under the contract, see Question 2.3.85.

Whether DAC is amortized at an individual contract or group level, the assumptions used to determine the expected term should be consistent with the assumptions used to estimate the related liability for future policy benefits. Accordingly, relevant updates made to calculate the liability should also be made to the expected term used to calculate amortization. The liability is discussed in chapter 2. [944-30-35-3A]

Judgment is needed to apply the relevant contract assumptions used to calculate the liability for future policy benefits on a grouped contract basis (e.g. termination assumptions) to the expected term when DAC is amortized on an individual contract basis. This application should approximate the expected term used for amortization.

An entity should disclose its policy for developing the expected term. [944-30-50-2A]

Question 4.4.40 For contracts with an accumulation and payout phase, what is the expected term?

Interpretive response: For these contracts, each phase is considered a separate accounting contract under Topic 944-30 that should not be combined. Capitalized acquisition costs associated with the issuance of the contract are amortized over the accumulation period. The payout phase should not be considered. [944-30-35-3]

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Question 4.4.45 For contracts with a GMWB feature accounted for as an MRB, what is the expected term?

Interpretive response: In determining the expected term of the contract, we believe that contracts with a GMWB feature accounted for as an MRB have two phases, consistent with the MRB guidance: [944-40-35-8B]

- the annuity contract with the MRB recorded at fair value – i.e. the deferred annuity; and
- after extinguishment of the account balance and derecognition of the MRB – i.e. the payout annuity.

For these contracts, we believe that the contract term for amortizing capitalized acquisition costs ends upon extinguishment of the account balance and derecognition of the MRB. We believe that this is consistent with the guidance for contracts with accumulation and payout phases. For more information on those contracts, see Question 4.4.40. [944-30-35-3]

Question 4.4.50 What is considered in determining the constant level basis for amortizing grouped contracts?

Interpretive response: Constant level basis for grouped contracts should approximate a pattern of straight-line amortization at an individual contract level. ASU 2018-12 does not prescribe a specific method to accomplish this result, except to specify that it should not be a function of revenue or profit emergence. We do not believe an entity is required to quantitatively demonstrate that the constant level basis amortization for grouped contracts approximates straight-line amortization on an individual contract basis. [944-30-35-3A]

The method selected should be specific to the underlying product. The following table illustrates some methods and whether they are expected to result in amortization on a constant level basis. The specific facts and circumstances of each product should be analyzed before reaching a conclusion.

Type of product(s)	Constant level basis method(s)
Examples of methods that <u>are</u> expected to result in amortization on a constant level basis	
• Term life • Whole life	• Face amount • Policy count, if contract benefit values are homogeneous
• Universal life	• Specified amount – i.e. level death benefit • Policy count, if contract benefit values are homogeneous
• Two-tier fixed annuities	• Original contract deposit

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Type of product(s)	Constant level basis method(s)
• Single premium deferred annuity (fixed and variable)	• Original contract deposit • Policy count, if contract benefit values are homogeneous
Examples of methods that might result in amortization on a constant level basis depending on individual facts and circumstances	
• Variable annuities	• Original deposit • Face amount of guaranteed minimum death benefit rider, if included and acts as a life insurance contract
• Long-term care	• Maximum lifetime benefit
Examples of methods that are <u>not</u> expected to result in amortization on a constant level basis	
• Term life • Whole life • Universal life	• Premiums • Anticipated earnings • Policy count, if contract benefit values are not homogeneous because there could be variability in amount of deferred costs
• Universal life	• Increasing death benefit – i.e. level net amount at risk, because it could change over the life of the contract based on cash inflows and outflows • Net amount at risk for contracts that are not highly funded, because this could change over life of the contract based on cash inflows and outflows
• Variable universal life	• Net amount at risk, because it could change over life of the contract due to changes in the fair value of the underlying separate account assets
• Long-term care contracts	• Original benefit, because changes to the expected contract-life benefit could result in a disconnect with DAC amortization
• Deferred annuities (fixed or variable)	• Number of policies, because variability in the amount of the deposit could cause variability in amount of related acquisition costs (e.g. commissions) capitalized
• Variable annuities	• Account value, because it is subject to market movement

An entity discloses its policy for determining the constant level basis of amortization when grouping contracts. [944-30-50-2A]

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Question 4.4.55 When is the DAC amortization rate calculated for grouped contracts?

Interpretive response: Under ASU 2018-12, capitalized acquisition costs are amortized on a constant level basis over the expected term of the related contracts. For contracts that are grouped to amortize DAC, we believe an entity can determine its accounting policy to calculate the amortization rate for the current period using one of the following methodologies. [944-30-35-3A]

Considerations	Methodology	
	As of the beginning of the current reporting period	**As of the end of the current reporting period**
What information is considered in determining the DAC amortization rate for the current reporting period?	Only information known at the beginning of the current reporting period. It excludes considering either the actual experience or any assumption updates made during the current reporting period.	All information available at the end of the current reporting period, including actual experience and any assumption updates.
Do future assumption updates affect the current reporting period amortization rates?	No. When the evaluation of actual experience results in the need to update future assumptions, there is no impact to the current reporting period amortization rates. Instead, those updated assumptions are used to calculate new amortization rates prospectively beginning in the subsequent reporting period.	Yes. The entity uses any updates of future assumptions resulting from actual experience to calculate revised amortization rates. The revised amortization rates are used prospectively as of the beginning of the current reporting period.
Is a separate experience adjustment required for the current reporting period?	Yes. If actual results are worse than expected, a separate experience adjustment is recorded to further reduce the DAC balance in the current reporting period.	No. Actual results are already considered in the updated amortization rate applied as of the beginning of the current reporting period.

Subtopic 944-30 Example 2 illustrates one method to calculate the DAC amortization rate for grouped contracts for a specific fact pattern. This example uses the 'beginning of the current reporting period' method. [944-30-55-7]

For a comparison between using the 'beginning of the current reporting period' method and the 'end of the current reporting period' when calculating the DAC amortization rate for grouped contracts for a specific fact pattern, see Example 4.4.30.

At transition, management determined its accounting policy to calculate the DAC amortization rate for grouped contracts. Once selected, we believe an entity should consistently apply that accounting policy for all of its contracts subject to the simplified DAC amortization under ASU 2018-12.

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Question 4.4.60 Is DAC evaluated for recoverability?

Interpretive response: No. Under ASU 2018-12, DAC is not evaluated for recoverability. DAC is viewed as historical cash flows incurred when the contract was initially issued or renewed. Further, amortization is not connected to revenue or profit emergence. Because there are no future cash flows, DAC is amortized over the expected term of the underlying contract and is not subject to impairment testing. [944-30-35-3A – 35-3B]

Question 4.4.70 Are the assumptions used to amortize DAC reviewed in subsequent periods?

Interpretive response: Yes. The underlying assumptions are reviewed each reporting period to determine whether they should be updated. Those assumptions should be consistent with the assumptions used to estimate the liability for future policy benefits (or any other related balances). Therefore, if necessary, the underlying assumptions for DAC and the liability for future policy benefits are unlocked at the same time. [944-30-35-3B]

Question 4.4.80 If actual results are better than expected, can an entity reverse amortization expense previously recognized?

Interpretive response: No. Amortization expense recognized in previous closed reporting periods cannot be reversed. For example, if a calendar-year entity that publishes quarterly results determines that results are better than expected in Q3 and concludes that the amount amortized each period should be reduced, it is prohibited from reversing any amortization expense recognized in Q1 or Q2.

Management will need to determine its accounting policy for applying the reduction in amortization expense when the entity's books and records for a reporting period are not published. For example, if a calendar-year entity that publishes quarterly results determines that results are better than expected in June, it will need to apply its selected accounting policy and either adjust amortization expense as of the beginning of the current open reporting period (e.g. April 1) or at the time the determination is made (e.g. June 30).

Assumptions, including expected term, should be reevaluated and updated, as needed (consistent with updates made for the related liability). The updated assumptions are used to calculate a new amortization amount prospectively. This may result in a reduction in amortization for the current period as compared to previous periods. [944-30-35-3B]

For further discussion about when the DAC amortization rate is calculated for grouped contracts, see Question 4.4.55.

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Question 4.4.90 If actual results are worse than expected, is an entity required to recognize additional amortization expense?

Interpretive response: Yes. An entity reduces the DAC balance for actual experience in excess of expected experience (e.g. contract terminations exceed expectations). If the evaluation of actual experience results in the need to update future assumptions, those revised assumptions are used to calculate new amortization amounts prospectively. [944-30-35-3B]

If contracts are grouped to amortize DAC and actual experience during the current reporting period exceeds expected experience, the recognition of additional amortization expense is dependent upon an entity's accounting policy election about when it calculates the DAC amortization rate. If an entity elected to calculate the DAC amortization rate as of the:

- beginning of the current reporting period, amortization expense is increased in the current reporting period via a separate experience adjustment to reduce the DAC balance for the actual experience; or
- end of the current reporting period, the DAC amortization rate is increased to reflect actual experience and used to calculate amortization expense for the current reporting period.

For further information about when the DAC amortization rate is calculated for grouped contracts, see Question 4.4.55.

For a comparison between using the 'beginning of the current reporting period' method and the 'end of the current reporting period' when calculating the DAC amortization rate for grouped contracts for a specific fact pattern, see Example 4.4.30.

Question 4.4.95 Can an entity update its DAC amortization for actual insurance in force without updating the net premium reserve calculation?

Interpretive response: Maybe. An entity reduces the DAC balance for actual experience in excess of expected experience in the period in which that actual experience occurs. This excess can result from unexpected contract terminations. Additionally, the assumptions used to amortize DAC should be consistent with the assumptions used to estimate the liability for future policy benefits. [944-30-35-3B]

An entity updates the net premium ratio used to calculate the liability for future policy benefits for actual experience at least annually at the same time every year when cash flow assumptions are reviewed and updated. At each interim period, an entity evaluates whether evidence exists that suggests the net premium ratio requires updating. [944-40-35-5 – 35-6]

In an interim period, we believe an entity may evaluate actual experience in excess of expected experience and conclude that it was not significant enough to require an update of the net premium ratio. This may occur because of the

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long-term nature of the underlying contracts. Depending on the specific facts and circumstances, we believe that updating the DAC amortization in the current reporting period for insignificant actual experience without updating the net premium ratio does not violate the principle that the assumptions should be consistent.

Question 4.4.100 Is interest accrued on the unamortized DAC balance?

Interpretive response: No. Interest does not accrue on the unamortized balance of capitalized acquisition costs. [944-30-35-3C]

Legacy US GAAP allowed the accrual of interest on the unamortized balance. However, because the capitalized balance represents historical cash flows and the simplified amortization method does not require using present value techniques, ASU 2018-12 prohibits accruing interest.

Question 4.4.110 Has the amortization of DAC related to internal replacement transactions changed?

Interpretive response: Yes. Under ASU 2018-12, an entity continues to apply the same criteria used under legacy US GAAP to determine whether a contract modification results in: [944-30-35-24 – 35-51]

- an internal replacement transaction (a contract termination and issuance of a new contract);
- a feature to be evaluated separately from the base contract; or
- the continuation of a contract.

When it is determined that an internal replacement transaction exists, an entity applies the simplified DAC amortization method consistent with deferred costs on a new contract. [944-30-35-36]

For a substantially unchanged contract accounted for as the continuation of a contract, ASU 2018-12 clarifies that the related liability for future policy benefits or MRBs is updated for the contract modification. [944-30-35-50]

Further, consistent with the applicability of the simplified DAC amortization under ASU 2018-12, the guidance for internal replacement transactions excludes investment contracts that do not include significant surrender charges or that yield significant revenues from sources other than the investment of contract holders' funds and are amortized consistent with the effective interest method in Subtopic 310-20. [944-30-35-19 – 35-20]

Question 4.4.120 Has the amortization of DAC related to limited-payment contracts changed?

Interpretive response: Yes. Under legacy US GAAP, acquisition costs incurred for limited-payment contracts were:

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- expensed immediately for single premium insurance contracts, because there was no future premium revenue; and
- amortized over the expected premium paying period for other limited-payment contracts – e.g. a long-duration five-year limited premium payment contract would amortize DAC over the five-year premium paying period.

Under ASU 2018-12, capitalized acquisition costs for all limited-payment contracts are amortized over the expected term of the related contracts on a constant level basis unrelated to revenue or profit emergence. [944-30-35-3A]

For further discussion about determining the expected contract term, see Question 4.4.30.

Example 4.4.10 Single premium deferred annuity – amortization using contract count

Life Insurer sells single premium deferred annuities and defers the following contract issue costs:

- commission of 5% of the original contract deposit; and
- issue costs of $100.

Life Insurer's accounting policy is to use the beginning of period expected insurance contracts in force to calculate current-period DAC amortization. For illustrative purposes, Life Insurer only produces annual financial statements – i.e. it does not report on an interim basis.

The following are the policy assumptions. The annual mortality assumption varies by attained age within each contract group and grades up over time. All contracts terminate at the end of the 10-year period.

Contract group	# of contracts	Deposit amount	Age	Annual mortality assumptions	Annual lapse assumption
No. 1	20	50,000	45	0.01% – 0.06%	5%
No. 2	20	100,000	50	0.02% – 0.06%	4%
No. 3	20	150,000	55	0.02% – 0.07%	3%
No. 4	20	200,000	60	0.03% – 0.07%	2%
No. 5	20	250,000	65	0.03% – 0.08%	1%

Scenario 1: Seriatim amortization

Life Insurer amortizes DAC on an individual contract (seriatim) basis using assumptions and experience specific to each individual policy to derive an approximate straight-line amortization amount on an individual contract basis.

The amount of annual amortization is calculated as the sum of:

- $1/X^{th}$ of the original DAC on an individual contract basis, where X is defined as the expected contract term based on best estimate assumptions and is recalculated at each valuation date for surviving policies – i.e. straight-line

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amortization over the remaining expected term as of each valuation date; and

- The writeoff of all remaining unamortized DAC for contracts that terminate before the end of the expected term using the mortality and lapse assumptions by contract group detailed above.

Scenario 2: Group amortization

Life Insurer has elected to amortize DAC using contract groups consistent with the groups used to estimate the liability for future policy benefits (or any other related balances).

To derive an approximate straight-line amortization amount over the expected term, Life Insurer:

- groups homogeneous contracts using similar size original contract deposit amounts; and
- amortizes them in proportion to policy count.

The diagram explains how the amortization for each year is calculated.



Scenario comparison: seriatim amortization vs group amortization

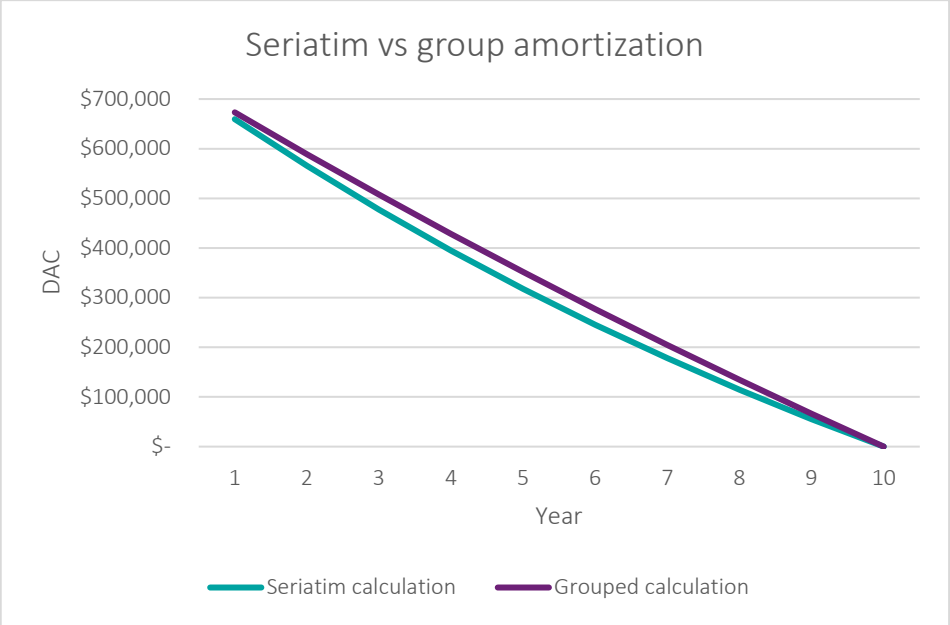
A grouped calculation pools contracts together and unamortized DAC on terminated contracts is written off through the amortization pattern alone, resulting in a single decrement.

Using a seriatim approach accelerates DAC amortization by reducing DAC twice for decrements: once in the amortization period (using expected terminations) and once when fully written off. This happens because:

- the amortization period used is the expected contract term, which includes a termination assumption resulting in an expected contract term less than the full contract term; and
- unamortized DAC is fully written off when an individual policy terminates.

As a result, the amount of DAC at the end of each period is different between the seriatim and grouped methodologies. However, the overall run-off pattern for contract groups approximates straight-line amortization on an individual contract basis, as illustrated below.

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Example 4.4.20 Single premium deferred annuity – amortization using original contract deposit

Assume the same facts as Example 4.4.10. Additionally, in Year 5, the actual lapse rate was 200% of expected experience. Life Insurer analyzed the facts and circumstances causing actual lapses to exceed expected lapses in Year 5. Life Insurer management concluded that this was a one-time variance and it did not need to update its lapse assumptions for Years 6 to 10.

Scenario 1: Seriatim amortization

The amount of annual amortization is calculated as the sum of:

- $1/X^{th}$ of the opening DAC on an individual contract basis, where X is defined as the expected opening initial deposit based on best estimate assumptions and is recalculated at each valuation date for surviving policies – i.e. straight-line amortization over the remaining expected term as of each valuation date; and
- The writeoff of all remaining unamortized DAC for contracts that terminate before the end of the expected term using the mortality and lapse assumptions by contract group detailed above.

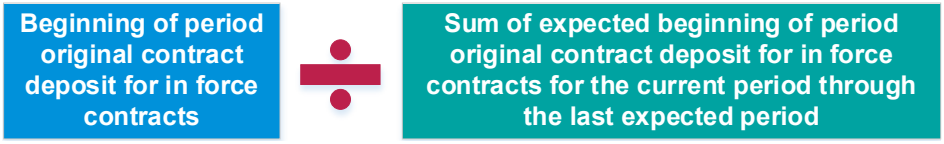
Scenario 2: Group amortization

Life Insurer has elected to amortize DAC using contract groups consistent with the groups used to estimate the liability for future policy benefits (or any other related balances). To derive an approximate straight-line amortization amount over the expected term, Life Insurer:

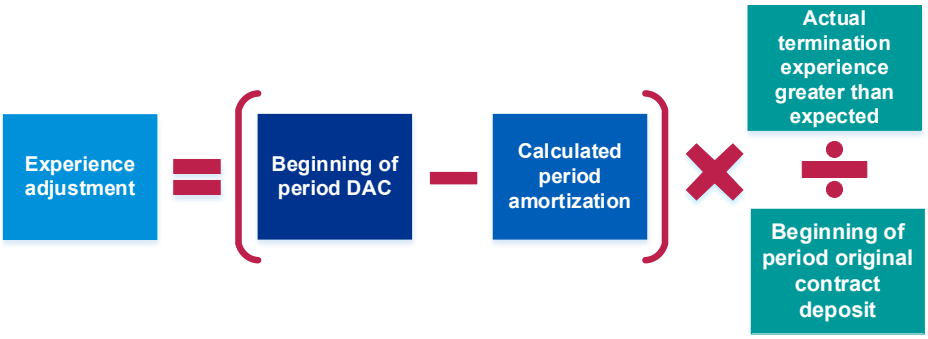
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- groups homogeneous contracts using similar size original contract deposit amounts; and
- amortizes them in proportion to the original contract deposit.

The diagram shows how the period amortization is calculated each year when actual experience is consistent with expectations.



Further, the following diagram shows how the amortization is calculated in years where actual experience is in excess of expected experience and a further reduction of the DAC balance is required.

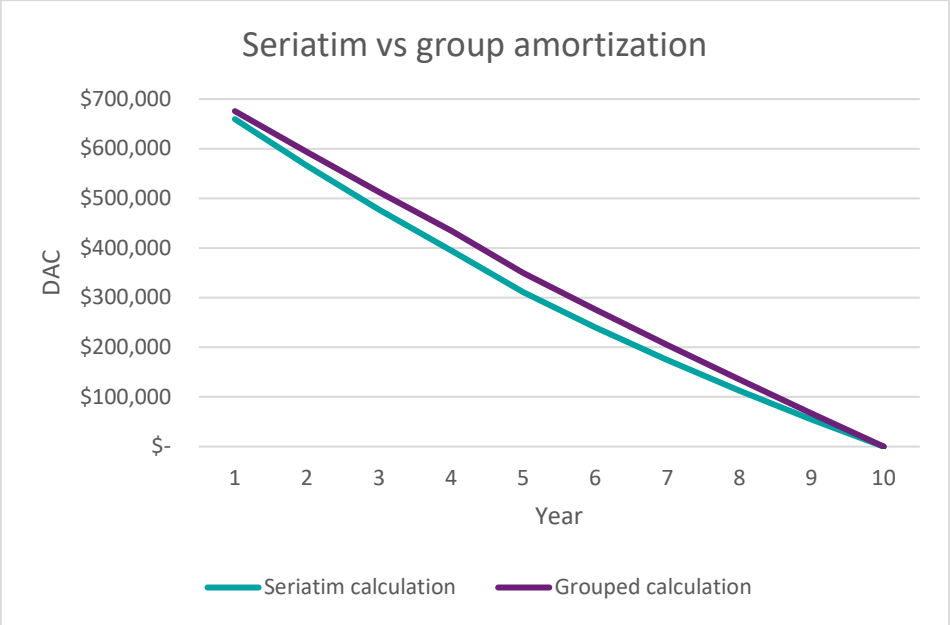


Scenario comparison: Seriatim amortization vs group amortization

As discussed in Example 4.4.10, a seriatim approach accelerates DAC amortization by reducing DAC twice for decrements whereas a group calculation results in a single decrement.

The following graph shows that the amount of DAC at the end of each period differs between the seriatim and grouped methodologies when amortized based on original contract deposit. However, the overall run-off pattern for contract groups approximates straight-line amortization on an individual contract basis.

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Example 4.4.30 Amortization for grouped contracts

Life Insurer writes five-year term life insurance contracts. Life Insurer's accounting policy is to group contracts to amortize capitalized acquisition costs. Contract and grouping details are as follows.

Deferred acquisition costs, at issuance	80
Constant level basis method/amount	Face amount/1,000
Expected term of the grouped contracts[1]	5 years

Note:
1. For guidance on determining the expected contract term, see Question 4.4.30.

For illustrative purposes, this example assumes lapse and mortality assumptions result in the following cumulative persistency rates and projected face amount for contracts in force at each year-end.

Year-end	Cumulative persistency rate	Projected face amount
Year 1	90%	900
Year 2	70%	700
Year 3	50%	500
Year 4	30%	300
Year 5	0%	0

During Year 2, Life Insurer experienced unfavorable experience. The actual persistency rate for Year 2 was 60%, as compared to the 70% expected persistency rate.

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Year-end	Cumulative actual persistency rate	Actual face amount
Year 1	90%	900
Year 2	60%	600
Year 3	50%	500
Year 4	30%	300
Year 5	0%	0

Life Insurer only produces annual financial statements – i.e. it does not report on an interim basis.

The numbers in this example are rounded.

Scenario 1: Calculate the amortization rate using the 'beginning of the current reporting period' method

Life Insurer's accounting policy is to use the 'beginning of the current reporting period' method to calculate its DAC amortization rate. This method considers only information known at the beginning of the current reporting period to calculate current-period DAC amortization rate.

Because Life Insurer calculates its DAC amortization rate as of the 'beginning of the current reporting period', in Year 2, it records a separate experience adjustment to reduce the DAC balance for the unfavorable experience that exceeds expected experience during the current reporting period – i.e. excess terminations. As such, Life Insurer records an experience adjustment of $5 in addition to the calculated annual amortization of $21 – see Notes 3 and 2 below, respectively, to derive those amounts.

Life Insurer then calculates a revised DAC amortization rate as of the beginning of Year 3. That revised DAC amortization rate is used as of the beginning of Years 3, 4 and 5 to calculate the respective period's DAC amortization because actual experience is the same as expected experience.

Year	Balance, beginning of year	Capitalized costs	Experience adjustment[3]	Amortization[1,2,4,5]	Balance, end of year[6]
1	–	80	–	24	56
2	56	–	5	21	30
3	30	–	–	13	17
4	17	–	–	11	6
5	6	–	–	6	–

Notes:

1. Calculation of Year 1 and Year 2 amortization rate (A): $80 of capitalized costs ÷ total expected face amount of $3,400[7] = 2.35%
2. Calculation of Year 1 and Year 2 amortization: Face amount at the beginning of the reporting period × (A)
3. Calculation of Year 2 experience adjustment: (($700 projected end of Year 2 face amount – $600 actual end of Year 2 face amount) ÷ $700 projected end of Year 2

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face amount) × $35 (end of Year 2 DAC balance using the Year 2 amortization rate, before experience adjustment) = $5

4. Calculation of Year 3 amortization rate (B): $30 of unamortized DAC at beginning of Year 3 ÷ total expected face amount of $1,400[8] = 2.14%
5. Calculation of Year 4 and Year 5 amortization: Face amount at the beginning of the reporting period × (B)
6. Balance, beginning of year + capitalized costs – experience adjustment – amortization = balance, end of year
7. Total beginning of Year 1 face amount ($1,000) + the expected ending face amount for Years 1 to 5 ($900 + $700 + $500 + $300 + $0)
8. Total beginning of Year 3 face amount ($600) + revised expected ending face amount for Years 3 to 5 ($500 + $300 + $0)

Scenario 2: Calculate the amortization rate using the 'end of the current reporting period' method

Life Insurer's accounting policy is to use the 'end of the current reporting period' method to calculate its DAC amortization. This method considers all information available at the end of the current reporting period, including actual experience and any assumption updates.

No separate experience adjustment exists because current reporting period experience is considered in the amortization rate applied as of the beginning of the current reporting period. That is, there is no difference between actual and expected experience for the current reporting period.

Year	Balance, beginning of year	Capitalized costs	Amortization[1,2,3,4]	Balance, end of year[5]
1	–	80	24	56
2	56	–	22	34
3	34	–	14	20
4	20	–	12	7
5	7	–	7	–

Notes:

1. Calculation of Year 1 amortization rate (C): $80 of capitalized costs ÷ total expected face amount of $3,400[6] = 2.35%
2. Calculation of Year 1 amortization: Face amount at the beginning of the reporting period × (C)
3. Calculation of Year 2 amortization rate (D): $56 of unamortized DAC at beginning of Year 2 ÷ total expected face amount of $2,300[7] = 2.43%
4. Calculation of Years 3 to 5 amortization: Face amount at the beginning of the reporting period × (D)
5. Balance, beginning of year + capitalized costs – amortization = balance, end of year
6. Total beginning of Year 1 face amount ($1,000) + the expected ending face amount for Years 1 to 5 ($900 + $700 + $500 + $300 + 0)
7. Total beginning of Year 2 face amount ($900) + the revised expected ending face amount for Years 2 to 5 ($600 + $500 + $300 + $0)

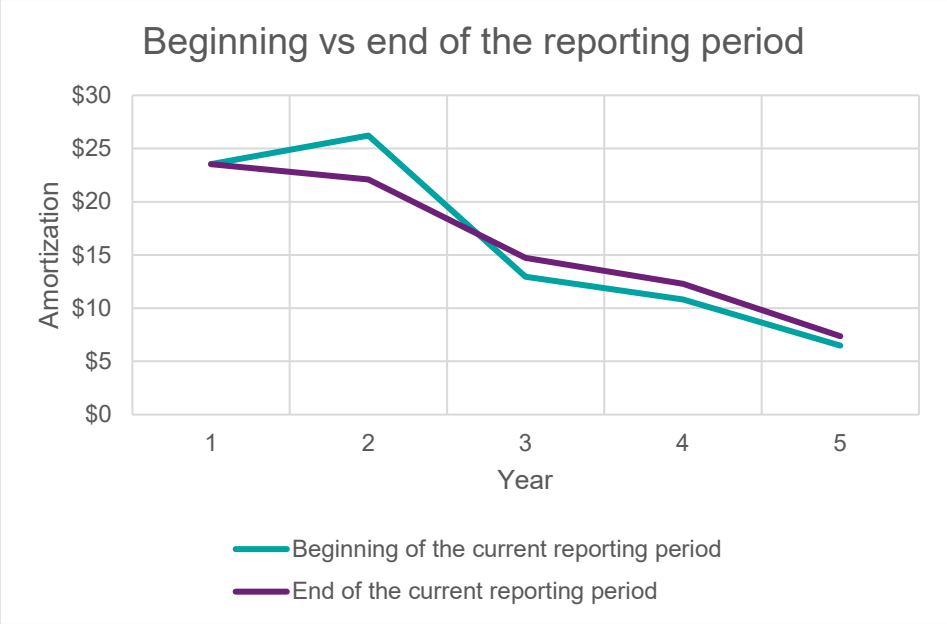
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Scenario comparison: 'Beginning of the current reporting period' vs 'end of the current reporting period' amortization methods

The graph below shows that the amount of DAC amortization for each period during the five-year contract life differs between the 'beginning of the current reporting period' and the 'end of the current reporting period' methods.

In scenario 1, the unfavorable experience in Year 2 is recognized as additional amortization expense (i.e. experience adjustment) in that period. Then, the Year 3 amortization rate is adjusted to recognize less amortization expense in future periods.

In scenario 2, the unfavorable experience in Year 2 is recognized over the Year 2 – Year 5 periods, resulting in higher amortization in those periods when compared to scenario 1.



The following table shows the amortization rates used to calculate the amount of DAC amortization above under the 'beginning of the current reporting period' and the 'end of the current reporting period' methods.

Yearly amortization rate		
Year	**Beginning of the current reporting period method**	**End of the current reporting period method**
1	2.35%	2.35%
2	2.35%[1]	2.43%
3	2.14%	2.43%
4	2.14%	2.43%
5	2.14%	2.43%

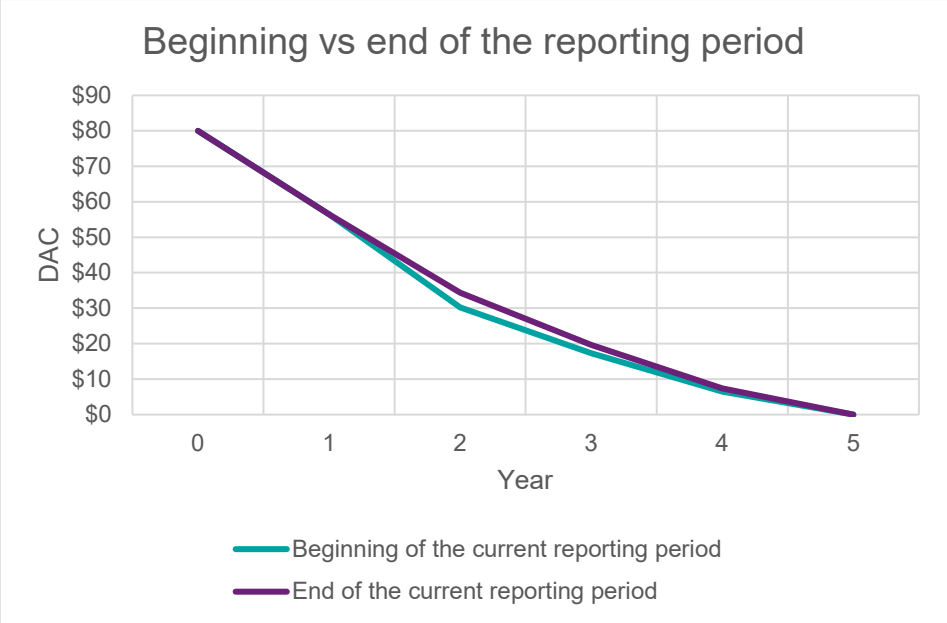
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Note:

1. The experience adjustment is excluded from the amortization rate applied in Year 2 because it is shown separately in scenario 1 from the calculated DAC amortization. The 'effective amortization rate', including the experience adjustment, is 2.89% ((amortization of $21 (2.35% × $900 face amount) + $5 experience adjustment) ÷ $900).

The graph below shows that the amount of DAC at the end of each period during the five-year contract life differs between the 'beginning of the current reporting period' and the 'end of the current reporting period' methods.

As a result of the differences in the amount of DAC amortization between scenarios 1 and 2, the amount of unamortized DAC at the end of each period is different. However, both methods result in an overall constant level basis pattern of DAC amortization over the expected term. This illustration assumes unfavorable experience only in Year 2. In a scenario where, in subsequent years, additional unfavorable experience occurs that is greater than expected, Life Insurer recalculates the amortization rate in those period(s).



For further discussion about when actual results are better than expected, see Question 4.4.80.

FASB Example

The following FASB example illustrates the 'beginning of the current reporting period amortization' method.

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Excerpt from ASC 944-30

Long-Duration Contracts

> Illustrations

• > Example 2: Computation of Amortization

55-7 This Example illustrates the computation of amortization on a constant level basis. In this Example, a block of long-duration guaranteed-renewable five-year term life insurance contracts are grouped and amortized in proportion to the amount of insurance **in force** to derive an approximate level amortization amount on an individual contract basis. In 20X1, the insurance entity defers costs totaling $80 and projects the balance of insurance in force over 5 years. The insurance entity would need to include mortality and lapse assumptions to project the balance of insurance in force; however, for ease of illustration, no mortality or lapses are assumed (see paragraph 944-30-55-7B for subsequent changes to the mortality and lapse assumptions).

Schedule One

Year	Balance of Insurance in Force	
20X1	$ 1,000	
20X2	1,000	
20X3	1,000	
20X4	1,000	
20X5	1,000	
Total	$ 5,000	(x)
Capitalized acquisition costs	$ 80	(y)
Amortization rate = (y)/(x)	1.60%	(z)

Schedule Two

Capitalized costs, year one	$ 80	
Amortization, year one		
Balance of insurance in force of $1,000 (from Schedule One) at rate (z) above	(16)	
Balance, end of year one	$ 64	

55-7A At the beginning of 20X2, the entity incurs an additional $10 of deferrable acquisition costs and computes the amortization rate and expense for 20X2 as follows.

Schedule Three

Year	Balance of Insurance in Force	
20X2	$ 1,000	

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20X3		1,000	
20X4		1,000	
20X5		1,000	
Total	$	4,000	(x)
Capitalized acquisition costs	$	74	(y)
Amortization rate = (y)/(x)		1.85%	(z)

55-7B At the end of 20X2, the entity experienced unexpected contract terminations that resulted in the writeoff of deferred acquisition costs at the end of the reporting period. In addition, the entity updated the expected balance of insurance in force for the remaining periods.

Schedule Four

Capitalized costs, year two	$	74	
Amortization, year two			
Balance of insurance in force of $1,000 (from Schedule Three) at rate (z) above		(19)	
Experience adjustment, end of year two			
Change in balance of insurance in force $55 × [(1,000-700) / 1,000]		(17)	
Balance, end of year two	$	38	

Schedule Five

Year		Balance of Insurance in Force	
20X3	$	700	
20X4		400	
20X5		200	
Total	$	1,300	(x)
Capitalized acquisition costs	$	38	(y)
Amortization rate = (y)/(x)		2.92%	(z)

Schedule Six

Capitalized costs, year three	$	38	
Amortization, year three			
Balance of insurance in force of $700 (from Schedule Five) at rate (z) above		(20)	
Balance, end of year three	$	18	

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Schedule Seven Deferred Acquisition Costs Rollforward					
Year	Balance, Beginning of Year	Capitalization	Experience Adjustment	Amortization	End of Year
20X1	$ -	$ 80	$ -	$ (16)	$ 64
20X2	64	10	(17)	(19)	38
20X3	38	-	-	(20)	18
20X4	18	-	-	(12)	6
20X5	6	-	-	(6)	-
Total		$ 90	$ (17)	$ (73)	

4.5 Sales inducements

4.5.10 Overview

Excerpt from ASC 944-20

Long-Duration Contracts

> Nontraditional Fixed and Variable Annuity and Life Insurance Contracts

• > Sales Inducements to Contract Holders

05-32 Sales inducements to contract holders may be offered with fixed and variable life insurance and annuity contracts. Sales inducements to contract holders typically can be characterized as one of the following types:

a. Immediate bonuses. In the case of the **immediate bonus**, the insurance entity is obligated to credit to the contract holder's account the sales inducement as a result of signing the contract. The contract holder account balance is increased for the full amount of the immediate bonus on the date that the bonus is contractually granted.
b. Persistency bonuses. A **persistency bonus** is credited to the contract holder account balance at the end of a specified period if the contract remains in force at that date.
c. **Enhanced-crediting-rate bonuses**. In an enhanced crediting rate sales inducement, the insurance entity offers customers a crediting rate for a stated period in excess of that currently being offered by the entity for other similar contracts. Pursuant to the contract, the enhanced crediting rate is applicable for a limited period of time, after which the rate is reset under the contractual provisions, typically at the discretion of the insurance entity.

20 Glossary

Sales Inducements

Contractually obligated inducements that are identified explicitly in a contract and are in excess of current market conditions. A sales inducement to a

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contract holder enhances the investment yield to the contract holder. The three main types of sales inducements are an **immediate bonus**, a **persistency bonus**, and an **enhanced-crediting-rate bonus**.

Insurance entities may offer sales inducements to contract holders with life insurance and annuity contracts. These inducements are typically in the form of immediate bonuses, persistency bonuses or enhanced-crediting-rate bonuses.

4.5.20 Capitalized sales inducements

Excerpt from ASC 944-30

Long-Duration Contracts

> Sales Inducements

25-6 Paragraph 944-30-25-7 addresses **sales inducements** that may be deferrable if the insurance entity can demonstrate that the sales inducement amounts have both of the following characteristics:

a. The amounts are incremental to amounts the entity credits on similar contracts without sales inducements.
b. The amounts are higher than the contract's expected ongoing crediting rates for periods after the inducement, as applicable; that is, the crediting rate excluding the inducement should be consistent with assumptions used in contract illustrations and interest-crediting strategies.

Due to the nature of **day-one bonuses** and **persistency** bonuses, the criteria in items (a) and (b) generally are met for such sales inducements.

25-7 Amounts specified in the preceding paragraph shall be deferred and amortized using the same methodology and assumptions used to amortize capitalized acquisition costs if the sales inducements have both of the following characteristics:

a. The sales inducements are recognized as part of the liability under paragraph 944-40-25-12.
b. The sales inducements are explicitly identified in the contract at inception.

ASU 2018-12 did not change the criteria for capitalizing sales inducements, except for removing the criteria related to evaluation of consistency with the emergence of future profits.

Sales inducements may be capitalized if: [944-30-25-6]

- they are incremental to amounts credited on similar contracts that do not have the inducement; and
- the amounts are higher than the crediting rates after the inducement.

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4.5.30 Amortization of capitalized sales inducements

Excerpt from ASC 944-30

Long-Duration Contracts

> Sales Inducements

35-18 Sales inducements deferred under paragraph 944-30-25-7 shall be amortized using the same methodology and assumptions used to amortize capitalized acquisition costs. No interest shall accrue to the unamortized balance of deferred sales inducements. In determining the amortization expense, future deferrable sales inducements shall not be included before the incurrence and capitalization of those sales inducements. The payout phase is viewed as a separate contract under this Topic and shall not be combined with the accumulation phase for amortization of deferred sales inducements.

Consistent with legacy US GAAP, capitalized sales inducements are amortized using the same methodology and assumptions used to amortize DAC if: [944-30-25-7]

- they are recognized as part of the sales inducement liability; and
- explicitly identified in the contract at issuance.

Question 4.5.10 Has amortization for capitalized sales inducements changed?

Interpretive response: Yes. The amortization of capitalized deferred sales inducements changes to the simplified method of amortization consistent with DAC, including not accruing interest to the unamortized balance and not deferring future sales inducements before their incurrence and capitalization. See section 4.4.20. [944-30-35-18]

4.6 Shadow DAC

Legacy US GAAP required DAC balances to be adjusted for unrealized capital gains and losses if they were amortized using estimated gross profits. The pattern of the cash flows generated by the related contracts (gross profit stream) was adjusted as if the unrealized gains and losses on available-for-sale securities had been realized. This adjustment offset the implications of holding those assets at fair value on the balance sheet and was commonly referred to as shadow DAC.

ASU 2018-12 eliminates the amortization of DAC using revenue or profit emergence. Therefore, capitalized acquisition costs no longer meet the criteria to apply shadow accounting. [944-30-35-3A, 320-10-S99-2]

For a discussion about shadow adjustments, see section 5.3.

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4.7 Other balances amortized on a basis consistent with DAC

Under legacy US GAAP, there are certain balances (e.g. unearned revenue reserve, VOBA, PVFP, cost of reinsurance) that are amortized on a basis consistent with DAC – either as required by Subtopic 944-30 or as a result of an accounting policy election.

ASU 2018-12 changed the amortization of DAC. During transition, an entity evaluated its policy election to amortize other balances, except unearned revenue reserve, on a basis consistent with DAC. For further discussion on transition, see section 7.3.40.

For further discussion about balances amortized on a basis consistent with DAC, see section 5.2.

4.8 Reinsurance

The simplification of DAC amortization also changed the accounting for acquisition costs involving reinsurance contracts.

Excerpt from ASC 944-30

Reinsurance Contracts

35-64 Proceeds from **reinsurance** transactions that represent recovery of **acquisition costs** shall reduce applicable unamortized acquisition costs in such a manner that net acquisition costs are capitalized and charged to expense in accordance with the amortization guidance in this Section that applies to those unamortized acquisition costs.

Excerpt from ASC 944-40

Reinsurance Contracts

25-34 Reinsurance recoverables shall be recognized in a manner consistent with the liabilities (including estimated amounts for claims incurred but not reported and future policy benefits) relating to the underlying reinsured contracts. Assumptions used in estimating reinsurance recoverables shall be consistent with those used in estimating the related liabilities.

Question 4.8.10 Has the accounting for acquisition costs involving assumed reinsurance contracts changed?

Interpretive response: Yes. The amortization of capitalized acquisition costs for assumed reinsurance contracts follows the simplified guidance in ASU 2018-12. Under ASU 2018-12, capitalized costs will be recognized in earnings on a

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constant level basis using a measure other than premiums or profit emergence. [944-30-35-3A]

However, it did not change the requirement to account for the net cost to the assuming insurance entity as an acquisition cost. [944-30-25-13]

Question 4.8.20 Has the amortization of ceding commissions for ceded reinsurance contracts changed?

Interpretive response: Yes. Under ASU 2018-12, proceeds received from a ceded reinsurance contract that represent the recovery of acquisition costs (i.e. ceding commission) are amortized consistent with DAC. [944-30-35-64]

Under legacy US GAAP, this ceding commission reduced applicable unamortized acquisition costs from direct and assumed contracts resulting in a net carrying amount of DAC. ASU 2018-12 does not change that guidance. [944-30-35-64]

Under ASU 2018-12, the recovery of acquisition costs is recognized in earnings on a constant level basis using a measure other than premiums or profit emergence. [944-30-35-3A]

Question 4.8.30 Has the accounting for the cost of reinsurance changed?

Interpretive response: It depends. Legacy US GAAP did not specifically define the cost of reinsurance or its method of amortization. However, it was typically amortized on a basis consistent with DAC. ASU 2018-12 changed the method to amortize DAC. Therefore, at transition, an entity evaluated its amortization method for the cost of reinsurance.

For a discussion about balances amortized on a basis consistent with DAC as a result of an accounting policy election, see section 5.2.

Question 4.8.40 How does an entity account for ceding commission received that represents the recovery of acquisition costs?

Interpretive response: Proceeds from a reinsurance contract that represents recovery of acquisition costs – i.e. ceding commission – reduce applicable unamortized acquisition costs. The resulting net acquisition costs are amortized on a constant level basis consistent with the simplified DAC amortization method. [944-30-35-3A, 35-64]

Any ceding commission received in excess of unamortized acquisition costs is expensed immediately.

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Question 4.8.50 Can an entity group contracts assumed in a reinsurance agreement for DAC amortization?

Interpretive response: It depends. An assuming entity capitalizes the net costs it incurs to successfully enter into a reinsurance contract as acquisition costs. Under ASU 2018-12, capitalized acquisition costs for assumed reinsurance contracts are amortized on a constant level basis over their expected term. However, Topic 944 does not provide guidance on the unit of account for assumed traditional and limited-payment long-duration reinsurance contracts. Therefore, an assuming entity needs to use judgment to determine the unit of account for recognition and measurement of the liability for future policy benefits (assumed), which informs the unit of account (grouping) it will use to amortize capitalized acquisition costs. [944-30-25-13, 35-3A]

For example, if an assuming entity elects to use a look-through approach to recognize and measure a prospective reinsurance contract (assumed) (see Question 2.5.310) and also elects to group assumed contracts to amortize capitalized acquisition costs, those groups should be consistent with the groups used to estimate the liability for future policy benefits or any other related balances for those same assumed contracts. [944-30-35-3A(b)]

For further guidance around determining the unit of account for assumed traditional and limited-payment long-duration assumed reinsurance contracts, see Question 2.5.310.

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5. Other accounting items

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Questions

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5.4 Deferred profit liability

Questions

Question 5.4.10 Are the assumptions used to estimate the DPL and the liability for future policy benefits updated at the same time?

Question 5.4.20 What costs should an entity include in its DPL calculations?

Question 5.4.30 How is the remeasurement gain (loss) of the DPL for limited-payment contracts recorded?

Question 5.4.40 Where is the remeasurement gain (loss) of the DPL for limited-payment contracts recorded?

5.5 Unearned revenue reserve

Question

Question 5.5.10 Is there a change to the amortization method for URR?

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5.1 How the standard works

ASU 2018-12 may impact certain other accounting balances under legacy US GAAP.

Comparison to legacy US GAAP Legacy US GAAP vs ASU 2018-12

The following table summarizes the key changes from legacy US GAAP for other accounting balances.

Legacy US GAAP	ASU 2018-12
Other balances [944-40-65-2(c)]	
Other balances without a prescribed amortization method may have been amortized on a basis consistent with DAC (policy election).	• Does not prescribe a specific amortization method. • Expands disclosure about other balances amortized on a basis consistent with DAC.
Deferred profit liability for limited-payment contracts	
Gross premiums received in excess of net premiums were deferred. [944-605-25-4A]	No change, except for explicit guidance on costs excluded from net premium. [944-40-30-15]
Interest was accrued on the unamortized balance using the locked-in expected net investment yield. [944-605-35-1]	Interest accrues on the unamortized balance at the original locked-in discount rate used at contract issue date. [944-605-35-1 – 35-1B]
The unamortized balance was amortized using the discounted amount of insurance in force or expected future benefit payments. [944-605-35-1]	The unamortized balance is amortized using the discounted amount of insurance in force (life insurance contracts) or expected future benefit payments (annuity contracts) – *and* using an upper-medium grade (low-credit-risk) fixed-income instrument yield. [944-605-35-1 – 35-1A]
Not addressed.	Assumptions used to measure the DPL are: • consistent with those used to measure the liability for future policy benefits; and [944-605-30-2A] • reviewed at least annually. [944-605-35-1B]
Not addressed.	Current-period change in the DPL estimate (i.e. liability remeasurement gain (loss)) is presented separately in net income (parenthetically or in a separate line item). [944-40-45-4]

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Legacy US GAAP	ASU 2018-12
Unearned revenue reserve	
Amortized using the same assumptions and factors used to amortize DAC. [944-605-35-2]	Amortized using the simplified DAC amortization method. [944-605-35-2]

The following table summarizes account balances that may have had shadow adjustments under legacy US GAAP and the related treatment under ASU 2018-12.

Account balance	ASU 2018-12
Shadow adjustments [320-10-S99-2]	
DAC.	No shadow adjustments because unrealized investment gains and losses are not considered in DAC amortization.
Deferred sales inducements.	No shadow adjustments because it is amortized on a basis consistent with DAC.
Unearned revenue reserve.	No shadow adjustments because it is amortized on a basis consistent with DAC.
PVFP/VOBA and cost of reinsurance.	Shadow adjustments are made if the amortization method considers unrealized investment gains and losses.
Additional liability for death or other insurance benefit features, including profits followed by losses.	Shadow adjustments are made if an additional liability considers investment performance.
Loss recognition, premium deficiency reserves and policyholder dividend obligation reserves for closed block participating contracts.	Shadow adjustments are considered for participating life insurance contracts meeting the requirements of paragraph 944-20-15-3.

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5.2 Other balances

ASU 2018-12 provides a simplified DAC amortization method for long-duration contracts (see section 4.4).

Under legacy US GAAP, an entity may have amortized certain balances on a basis consistent with DAC. Examples included the cost of reinsurance and amortizable intangible assets acquired in a business combination – e.g. VOBA or PVFP.

Under ASU 2018-12, an entity continues using its legacy US GAAP amortization methodology or changes to the simplified DAC amortization method.

Excerpt from ASC 944-40

General

> Transition Related to Accounting Standards Updates No. 2018-12, *Financial Services–Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, No. 2019-09, *Financial Services–Insurance (Topic 944): Effective Date*, and No. 2020-11, *Financial Services-Insurance (Topic 944): Effective Date and Early Application*

65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2018-12, Financial Services-Insurance (Topic 944): *Targeted Improvements to the Accounting for Long-Duration Contracts,* No. 2019-09, *Financial Services–Insurance (Topic 944): Effective Date,* and No. 2020-11, *Financial Services-Insurance (Topic 944): Effective Date and Early Application:* …

Liability for future policy benefits and deferred acquisition costs

c. At the transition date, an insurance entity shall apply the pending content that links to this paragraph about the **liability for future policy benefits** and deferred **acquisition costs** (and balances amortized on a basis consistent with deferred acquisition costs, either as required by this Topic or as a result of an accounting policy election) to contracts **in force** on the basis of their existing carrying amounts at the transition date and by using updated cash flow assumptions, adjusted for the removal of any amounts in accumulated other comprehensive income.

…

e. An insurance entity may elect to apply the pending content that links to this paragraph retrospectively (with a cumulative catch-up adjustment to the opening balance of retained earnings or the opening balance of accumulated other comprehensive income, as applicable, as of the transition date) using actual historical experience information as of contract inception (or contract acquisition, if applicable). For consistency:
   1. An insurance entity shall apply the same transition method to both the liability for future benefits and deferred acquisition costs (and balances amortized on a basis consistent with deferred acquisition costs, either as required by this Topic or as a result of an accounting policy election).

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Excerpt from ASC 944-30

Long-Duration Contracts

> Insurance Contracts

35-3 Capitalized **acquisition costs** shall be charged to expense using assumptions consistent with those used in estimating the **liability for future policy benefits** (or any other related balance) for the corresponding contracts (see Subtopic 944-40), as applicable (for example, **terminations**). For contracts with accumulation and payout phases, the **payout phase** shall be viewed as a separate contract under this Topic and shall not be combined with the **accumulation phase** for amortization of capitalized acquisition costs.

35-3A Acquisition costs capitalized under paragraphs 944-30-25-1A through 25-1AA shall be charged to expense on a constant level basis—either on an individual contract basis or on a grouped contract basis—over the expected term of the related contract(s) as follows:

a. Individual contracts. Capitalized acquisition costs shall be charged to expense on a straight-line basis.
b. Grouped contracts. Capitalized acquisition costs shall be charged to expense on a constant level basis that approximates straight-line amortization on an individual contract basis. Contracts shall be grouped consistent with the grouping used in estimating the liability for future policy benefits (or any other related balance) for the corresponding contracts.

The resulting amortization amount shall not be a function of revenue or profit emergence. The amortization method shall be applied consistently over the expected term of the related contract(s).

Internal Replacement Transactions

> Recoverability

35-63 Unamortized deferred acquisition costs for short-duration contracts and the present value of future profits continue to be subject to premium deficiency testing in accordance with the provisions of Subtopic 944-60.

Excerpt from ASC 944-60

Long-Duration Contracts

> Instruments

15-5 The guidance in the Long-Duration Contracts Subsections of this Subtopic applies to long-duration contracts, except for the liability for future policy benefits for traditional and limited-payment contracts subject to the guidance in paragraph 944-40-25-11. Paragraph 944-30-35-63 specifies that the present value of future profits relating to insurance (including traditional and limited-payment) and reinsurance contracts acquired is subject to premium deficiency testing in accordance with the provisions of this Subtopic (see paragraph 944-805-35-3)…

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25-7 Original policy benefit assumptions for certain long-duration contracts ordinarily continue to be used during the periods in which the **liability for future policy benefits** is accrued under Subtopic 944-40. However, actual experience with respect to investment yields, **mortality**, **morbidity**, terminations, or expenses may indicate that **existing contract** liabilities, together with the present value of future gross premiums, will not be sufficient to do both of the following:

a. Cover the present value of future benefits to be paid to or on behalf of policyholders and settlement costs relating to a block of long-duration contracts
b. Recover unamortized present value of future profits.

25-8 The premium deficiency shall be recognized by a charge to income and either of the following:

a. A reduction of unamortized present value of future profits
b. An increase in the liability for future policy benefits.

30-1 If the conditions in paragraph 944-60-25-7 exist, an entity shall determine the **liability for future policy benefits** using revised assumptions as the remainder of the present value of future payments for benefits and related settlement costs (determined using revised assumptions based on actual and anticipated experience) minus the present value of future gross premiums (also determined using revised assumptions based on actual and anticipated experience).

30-2 A premium deficiency shall then be determined as the liability measured in paragraph 944-60-30-1 minus the liability for future policy benefits at the valuation date, reduced by the unamortized present value of future profits.

35-5 If a premium deficiency does occur, future changes in the liability shall be based on the revised assumptions. No loss shall be reported currently if it results in creating future income. The **liability for future policy benefits** using revised assumptions based on actual and anticipated experience shall be estimated periodically for comparison with the liability for future policy benefits (reduced by the unamortized present value of future profits) at the valuation date.

Excerpt from ASC 944-805

General

> Insurance and Reinsurance Contracts Acquired

35-1 After the business combination, the acquirer shall measure the intangible asset (or other liability) on a basis consistent with the related insurance or **reinsurance** liability.

35-3 For certain long-duration contracts such as traditional life insurance contracts, using a basis consistent with the measurement of the liability would be similar to the guidance provided in paragraph 944-30-35-3, which requires that deferred **acquisition costs** be amortized using methods that include assumptions consistent with those used in estimating the **liability for future policy benefits**, including subsequent revisions to those assumptions. Also,

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paragraph 944-30-35-63 specifies that the present value of future profits is subject to premium deficiency testing in accordance with the provisions of Subtopic 944-60.

Question 5.2.10 Is there a change to the amortization method for other balances amortized on a basis consistent with DAC?

Interpretive response: Maybe. ASU 2018-12 does not change the guidance for the amortization of other balances that an entity elects to amortize on a basis consistent with DAC. After a business combination, an entity is required to measure the intangible asset (or other liability) on a basis consistent with the related insurance or reinsurance liability. However, no specific amortization methods are prescribed under legacy US GAAP or ASU 2018-12. [944-805-35-1 – 35-3]

At transition, for balances amortized on a basis consistent with DAC under legacy US GAAP, ASU 2018-12 allows an entity to apply the simplified DAC amortization method. An entity may also retain its legacy US GAAP amortization method. For further discussion about whether the amortization method for other balances amortized on a basis consistent with DAC can be changed during transition, see Question 5.2.20. For further discussion about the amortization of DAC, see section 4.4. [944-40-65-2(c), 65-2(e)(1)]

Question 5.2.20 Is a change to the amortization method for these balances a change in accounting principle?

Interpretive response: It depends on the amortization method elected under legacy US GAAP. [944-40-65-2(c)]

Legacy US GAAP amortization method	Can this be changed during transition?
• On a basis consistent with DAC. • In proportion to premiums, estimated gross profits or estimated gross margins.	Yes, can change to the simplified amortization method.
Using an alternative method.	No change permitted by ASU 2018-12. If an entity wants to change its historical amortization method, we would expect it to follow the guidance for changing the method of applying an accounting principle in Topic 250, Accounting changes and error corrections. If the entity is an SEC registrant, a preferability letter from its independent accountant is required.

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Question 5.2.30 Is premium deficiency testing required for purchased insurance contract intangible assets?

Interpretive response: Yes. A premium deficiency test is required for purchased insurance contract intangible assets – e.g. VOBA and PVFP – under the requirements of Subtopic 944-60. ASU 2018-12 does not change this requirement. [944-30-35-63, 944-60-15-5]

Question 5.2.40 Is there a change to the level of aggregation used in the premium deficiency test?

Interpretive response: No. ASU 2018-12 does not change the guidance under legacy US GAAP. For further discussion about grouping of contracts for premium deficiency testing, see Question 2.5.30.

Question 5.2.50 What are the expected disclosures for a balance amortized on a basis consistent with DAC?

Interpretive response: If an entity elects to amortize certain other balances on a basis consistent with DAC, we expect the related disclosures, including those for transition, to follow the required disclosures for DAC. For further discussion about DAC disclosures, see Question 6.6.20. [944-30-50, 944-40-65-2C, 65-2(e)(1)]

5.3 Shadow adjustments

Under legacy US GAAP, shadow adjustments were made to the carrying amount of certain financial statement balances to reflect unrealized investment gains or losses as if they had been realized. This was done when realized investment gains or losses would have changed the measurement of those balances. These shadow adjustments offset the gross unrealized gains or losses in AOCI. [320-10-S99-2]

This accounting minimized the inconsistency and volatility in the financial statements for amounts amortized based on profit emergence. The inconsistency was minimized because: [320-10-S99-2]

- available-for-sale assets were recorded at fair value reflecting an 'as if sold' value on the reporting date, with the unrealized gains or losses recorded in AOCI; and
- amortization calculations based on profit emergence did not reflect the 'as if sold' value of those investments as realized gains or losses.

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Excerpt from ASC 320-10

• • > SEC Staff Announcement: Adjustments in Assets and Liabilities for Holding Gains and losses as Related to the Implementation of Subtopic 320-10

S99-2 The following is the text of SEC Staff Announcement: Adjustments in Assets and Liabilities for Holding Gains and Losses as Related to the Implementation of Subtopic 320-10.

The SEC staff has been asked whether certain assets and liabilities, such as noncontrolling interests, certain life insurance policyholder liabilities, deferred acquisition costs, and intangible assets arising from insurance contracts acquired in business combinations, should be adjusted with a corresponding adjustment to other comprehensive income at the same time unrealized holding gains and losses from securities classified as available-for-sale are recognized in other comprehensive income. That is, should the carrying value of these assets and liabilities be adjusted to the amount that would have been reported had unrealized gains and losses been realized?

Paragraph 740-20-45-11(b) addresses specifically the classification of the deferred tax effects of unrealized holding gains and losses reported in other comprehensive income. Paragraph 740-20-45-11(b) requires that the tax effects of those gains and losses be reported as charges or credits directly to other comprehensive income. That is, the recognition of unrealized holding gains and losses in equity may create temporary differences for which deferred taxes would be recognized, the effect of which would be reported in accumulated other comprehensive income along with the related unrealized holding gains and losses. Therefore, deferred tax assets and liabilities are required to be recognized for the temporary differences relating to unrealized holding gains and losses as though those gains and losses actually had been realized, except the corresponding charges or credits are reported in other comprehensive income rather than as charges or credits to income in the statement of income.

By analogy to paragraph 740-20-45-11(b), the SEC staff believes that, in addition to adjusting deferred tax assets and liabilities, registrants should adjust other assets and liabilities that would have been adjusted if the unrealized holding gains and losses from securities classified as available-for-sale actually had been realized. That is, to the extent that unrealized holding gains or losses from securities classified as available-for-sale would result in adjustments of noncontrolling interest, policyholder liabilities, deferred acquisition costs that are amortized using the gross-profits method, or intangible assets arising from insurance contracts acquired in business combinations that are amortized using the gross-profits method had those gains or losses actually been realized, the SEC staff believes that those balance sheet amounts should be adjusted with corresponding credits or charges reported directly to other comprehensive income. As a practical matter, the staff, at this time, would not extend those adjustments to other accounts such as liabilities for compensation to employees. The adjustments to asset accounts should be accomplished by way of valuation allowances that would be adjusted at subsequent balance sheet dates.

For example, certain policyholder liabilities should be adjusted to the extent that liabilities exist for insurance policies that, by contract, credit or charge the

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policyholders for either a portion or all of the realized gains or losses of specific securities classified as available-for-sale. Further, asset amounts that are amortized using the gross-profits method, such as deferred acquisition costs accounted for under paragraphs 944-30-35-4 and 944-30-35-11 and certain intangible assets arising from insurance contracts acquired in business combinations, should be adjusted to reflect the effects that would have been recognized had the unrealized holding gains and losses actually been realized. Further, capitalized acquisition costs associated with insurance contracts covered by paragraphs 944-30-35-1A through 35-3A and 944-30-35-17 should not be adjusted for an unrealized holding gain or loss unless a "premium deficiency" would have resulted had the gain or loss actually been realized.

This announcement should not affect reported net income. It addresses only the adjustment of certain assets and liabilities and the reporting of unrealized holding gains and losses from securities classified as available for sale.

Question 5.3.10 Is shadow accounting needed for DAC?

Interpretive response: No. Under legacy US GAAP, shadow accounting was needed for DAC because it was amortized using estimated gross profits or estimated gross margins that considered investment gains and losses. [320-10-S99-2]

ASU 2018-12 eliminates the use of profit emergence or revenue in amortizing DAC. Therefore, because unrealized investment gains and losses are no longer considered in amortizing DAC, there are no related shadow adjustments to be recognized. [944-30-35-3A]

Question 5.3.15 Is shadow accounting needed for deferred sales inducements?

Interpretive response: No. Under legacy US GAAP, deferred sales inducements were recognized using the same methodology and assumptions as those used to amortize DAC. ASU 2018-12 does not change that guidance. [944-30-25-7, 35-18]

Therefore, because ASU 2018-12 eliminates the need to recognize shadow adjustments for DAC, there are no related shadow adjustments recorded for deferred sales inducements. [944-30-35-18]

Question 5.3.20 Is shadow accounting needed for PVFP, VOBA or cost of reinsurance?

Interpretive response: It depends. If an entity elects to amortize PVFP, VOBA or cost of reinsurance on a basis consistent with DAC, it will no longer have shadow adjustments. This is consistent with Question 5.3.10. [944-30-35-3A, 320-10-S99-2]

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However, shadow accounting will still apply if an entity considers unrealized gains and losses when it: [320-10-S99-2]

- performs loss recognition testing; or
- elects to amortize these balances using an alternative method.

Question 5.3.30 Is shadow accounting needed for reserves?

Interpretive response: It depends. Under legacy US GAAP, unrealized gains and losses were considered in the current portfolio yield used to develop the gross premium reserve calculation. Because ASU 2018-12 does not change premium deficiency or loss recognition testing guidance for participating life insurance policies meeting the requirements of paragraph 944-20-15-3, shadow accounting still applies. [944-60-15-5]

For universal life-type contracts and nontraditional contract benefits, under ASU 2018-12, an entity recognizes an additional liability for death or other insurance benefits when the amounts assessed against the contract holder result in profits followed by losses. Shadow accounting still applies if this additional liability considers investment performance. [944-40-25-27A]

However, ASU 2018-12 eliminates the requirement for premium deficiency or loss recognition testing for the liability for future policy benefits for traditional and limited-payment contracts. Shadow accounting no longer applies for these contracts. [944-60-15-5]

For further discussion about applying shadow accounting to the additional liability established for universal life-type contracts with annuitization, death or other insurance benefit features, see Question 5.3.80.

Question 5.3.40 Does the unearned revenue reserve have shadow accounting?

Interpretive response: No. Under legacy US GAAP, the unearned revenue reserve for universal life and variable universal life was recognized using the same assumptions and factors as those used to amortize DAC, including estimated gross profits. ASU 2018-12 does not change that guidance. [944-605-35-2]

Therefore, because ASU 2018-12 eliminates the use of revenue or profit emergence in amortizing DAC, there are no related shadow adjustments recorded for the unearned revenue reserve. [944-30-35-3A, 320-10-S99-2]

Question 5.3.50 Is shadow accounting needed for MRBs?

Interpretive response: No. All MRBs are measured at fair value. As such, shadow accounting is not relevant for MRBs. [944-40-35-19C]

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Question 5.3.60 Is the expected investment yield used to measure the shadow accounting adjustment modified?

Interpretive response: Yes. For those assets and liabilities that are measured considering expected investment yields on available-for-sale securities, a shadow adjustment to their carrying amount is calculated to reflect unrealized gains or losses as if they had been realized. For the shadow calculation, an entity makes an 'as if sold' adjustment to the yield on the invested assets classified as available-for-sale that support the related asset or liability account balances to assume their sale. The entity:

- assumes the sale of these securities;
- assumes the reinvestment of those sales proceeds at then-current market rates; and
- estimates future investment yields at then-current market rates.

Therefore, total expected investment yields are a combination of the 'as if sold' realized gains and losses and estimated future investment yields at then-current market rates. If the supporting invested assets, by line of business (if applicable), are less than the related asset or liability account balances, the shortfall is made up with assets supporting equity, which may be non-earning assets. However, we do not believe an entity can use assets to support more than one line of business – i.e. double-count the support of those assets in funding the related liability. [320-10-S99-2]

For further guidance on what date to use when measuring the shadow account adjustment, see Question 5.3.70.

Question 5.3.70 What date is used to measure the shadow accounting adjustment?

Interpretive response: For those assets and liabilities that are measured considering expected investment yields on available-for-sale debt securities, a shadow adjustment to their carrying amount is calculated as of the balance sheet date. This adjustment reflects unrealized gains or losses as if they had been realized. As such, using the balance sheet date – and not an evaluation throughout the reporting period – is consistent with the recording of the unrealized gains and losses. This implementation guidance was issued through an SEC Staff Announcement made at an Emerging Issues Task Force Meeting in response to a concern that shareholders' equity was not properly reflecting all adjustments related to unrealized gains and losses at the balance sheet date – i.e. not just income taxes. [320-10-S99-2]

For further guidance on the expected investment yield used to measure the shadow account adjustment, see Question 5.3.60.

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Question 5.3.80 How is a shadow accounting adjustment to the additional liability established for universal life-type contracts with annuitization, death or other insurance benefit features recorded?

Interpretive response: A shadow adjustment is calculated when total expected assessments within the benefit ratio include investment margin related to available-for-sale debt securities that are reported in the general account. The calculated shadow amount adjusts the expected assessments in the measurement of the additional liability for the hypothetical realization of the unrealized holding gains and losses on those available-for-sale debt securities. [320-10-S99-2]

For universal life-type contracts, an entity may be required to establish an additional liability for annuitization, death or other insurance benefits that is determined based on a benefit ratio. The benefit ratio is calculated as the present value of total expected excess payments over the life of the contract divided by the present value of total expected assessments over the life of the contract. Expected assessments include investment margin when assets are reported in the general account. [944-40-30-20, 30-22]

When an entity records a shadow liability adjustment, it also records a corresponding amount in other comprehensive income. [320-10-S99-2]

For further guidance on the expected investment yield used to measure the shadow account adjustment, see Question 5.3.60.

5.4 Deferred profit liability

Consistent with legacy US GAAP, ASU 2018-12 requires that an entity with limited-payment contracts:

- record a DPL for the gross premium received in excess of the net premium; and [944-605-25-4A]
- recognize the DPL in income in a constant relationship with insurance in force or with the amount of expected future benefit payments. [944-605-35-1]

ASU 2018-12 further specifies that the cash flow assumptions used to calculate the DPL should be:

- consistent with the assumptions used to measure the liability for future policy benefits; and [944-605-30-2A]
- reviewed annually at the same time every year, using actual historical experience and updated future cash flow assumptions. The review must be done at the same time that the entity reviews the liability for future policy benefits. [944-605-35-1B – 35-1C]

ASU 2018-12 also requires an entity to recalculate the DPL as of the original contract issue date using the cash flow assumptions at each subsequent reporting period. The recalculated balance is amortized using the discounted amount of insurance in force or the amount of expected future benefit

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payments in order to calculate the DPL estimate as of the beginning of the current reporting period. The recalculated DPL as of the beginning of the current reporting period is compared with the previous carrying amount. The difference is recognized as a remeasurement gain (loss) cumulative catch-up adjustment in income. [944-605-35-1C]

The unamortized DPL balance accrues interest. The amount of insurance in force or the amount of expected future benefit payments is discounted using the same locked-in upper-medium grade (low-credit-risk) fixed-income instrument yield as the liability for future policy benefits. [944-605-35-1A]

The current-period change in the DPL is presented separately in net income, either parenthetically or in a separate line item. [944-40-45-4]

Excerpt from ASC 944-30

Long-Duration Contracts

> Limited-Payment Contracts

25-8 Costs related to the acquisition of new and renewal business that are not capitalized (because they do not meet the criteria for capitalization in paragraphs 944-30-25-1A through 25-1 AA) and costs that are required to be charged to expense as incurred, such as those relating to investments, general administration, policy **maintenance costs**, product development, market research, and general overhead (see paragraphs 944-40-30-15 and 944-720-25-2) are period costs that shall be recognized when incurred. Such costs shall not be included in the calculation of **net premium** used in determining the profit to be deferred on **limited-payment contracts** because the inclusion of such costs in the calculation of net premium would result in their deferral.

25-9 Costs that would be included in the determination of net premium under this Subtopic are policy-related costs that are not primarily related to the acquisition of business (such as termination or settlement costs; see paragraph 944-40-30-15).

Excerpt from ASC 944-605

Long-Duration Contracts

> Limited-Payment Contracts

25-4A Because the collection of premium under a limited-payment contract does not represent the completion of an earnings process, any **gross premium** received in excess of the net premium shall be deferred.

30-2A Assumptions used in measuring any **gross premium** deferred in accordance with paragraph 944-605-25-4A (that is, the deferred profit liability) shall be consistent with those used in estimating the **liability for future policy benefits** as described in paragraph 944-40-30-7.

35-1 Any **gross premium** deferred in accordance with paragraph 944-605-25-4A (that is, the deferred profit liability) shall be recognized in income in a constant relationship with insurance **in force** (if accounting for life insurance

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contracts) or with the amount of expected future benefit payments (if accounting for annuity contracts).

35-1A The deferred profit liability shall be amortized in relation to the discounted amount of the insurance in force or expected future benefit payments, discounted as described in paragraph 944-40-30-9, and interest shall accrue to the unamortized balance. The use of interest in the amortization is consistent with the determination of the deferred profit using discounting.

35-1B Assumptions shall be updated in subsequent accounting periods to determine changes in the deferred profit liability, contemporaneously with the updating of assumptions for the corresponding **liability for future policy benefits** (see paragraph 944-40-35-5). Cash flow assumptions shall be reviewed—and if there is a change, updated—on an annual basis, at the same time every year. Cash flow assumptions shall be updated in interim reporting periods if evidence suggests that earlier cash flow assumptions should be revised. The interest accretion rate shall remain the original discount rate used at contract issue date.

35-1C A related charge or credit to net income for the current reporting period as a result of updating cash flow assumptions at the level of aggregation at which reserves are calculated shall be determined as follows:

a. Cash flow assumptions used to calculate the deferred profit liability at contract issuance shall be updated in subsequent periods using actual historical experience and updated future cash flow assumptions.
b. The recalculated deferred profit liability as of the contract issue date shall be subsequently amortized in accordance with paragraph 944-605-35-1A to derive the revised deferred profit liability estimate as of the beginning of the current reporting period.
c. The revised deferred profit liability estimate calculated in (b) shall be compared with the carrying amount of the deferred profit liability as of the beginning of the current reporting period to determine the change in estimate adjustment to be recognized in net income for the current reporting period (see paragraph 944-40-45-4).

Excerpt from ASC 944-40

Long-Duration Contracts

> Traditional and Limited-Payment Contracts

45-4 … For limited-payment contracts, the corresponding current-period change in estimate of the deferred profit liability (that is, the liability remeasurement gain or loss) calculated under paragraph 944-605-35-1C shall be presented separately in net income, either parenthetically or as a separate line item. The liability remeasurement gain or loss for traditional and limited-payment contracts may be reported together with the liability remeasurement gain or loss related to annuitization benefits and death or other insurance benefits.

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Question 5.4.10 Are the assumptions used to estimate the DPL and the liability for future policy benefits updated at the same time?

Interpretive response: Yes. Actual experience and expected assumptions used to estimate the DPL are updated when actual experience and expected assumptions used to estimate the liability for future policy benefits are updated. They should be reviewed annually at the same time every year. If a change is necessary, the DPL should be re-estimated, but the interest accretion rate remains the locked-in discount rate used at the original contract issue date. [944-605-35-1B]

Question 5.4.20 What costs should an entity include in its DPL calculations?

Interpretive response: Under legacy US GAAP, costs that did not meet the criteria for capitalization in paragraphs 944-30-25-1A – 25-1AA were expensed as incurred. Therefore, those costs were not included in the calculation of net premium used to determine the DPL. ASU 2018-12 does not change that guidance. [944-30-25-8]

Under the ASU, an entity includes estimates of nonlevel costs, including termination and settlement costs when estimating the DPL. [944-30-25-8 – 25-9]

However, the expense assumptions do not include the following costs: [944-30-25-8 – 25-9]

- DAC;
- investment;
- general administration;
- policy maintenance;
- product development;
- market research; and
- general overhead.

One of the exclusions is policy maintenance costs, which are associated with maintaining records relating to insurance contracts and the processing of premium collections and commissions. Legacy US GAAP did not explicitly exclude these costs. [944-40 Glossary]

Question 5.4.30 How is the remeasurement gain (loss) of the DPL for limited-payment contracts recorded?

Interpretive response: At least annually, an entity recalculates the DPL as of the original contract issue date using actual historical experience and updated future cash flow assumptions, consistent with the liability for future policy benefits. The recalculated balance is amortized using the discounted amount of insurance in force or the amount of expected future benefit payments to calculate the DPL estimate as of the beginning of the current period. The

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recalculated DPL as of the beginning of the current reporting period is compared with the previous carrying amount to determine the remeasurement gain (loss) recorded in net income. [944-605-35-1B, 35-1C]

Question 5.4.40 Where is the remeasurement gain (loss) of the DPL for limited-payment contracts recorded?

Interpretive response: We believe an entity records the remeasurement gain (loss) of the DPL for limited-payment contracts in the same financial statement caption where it recognizes the current-period change in DPL in income. [944-605-35-1]

5.5 Unearned revenue reserve

Excerpt from ASC 944-605

Long-Duration Contracts

> Universal Life-Type Contracts

25-6 Amounts assessed that represent compensation to the insurance entity for services to be provided in future periods are not earned in the period assessed. Such amounts shall be recognized as unearned revenue.

25-7 Amounts that are assessed against the policyholder balance as consideration for origination of the contract, often referred to as **initiation or front-end fees**, shall be recognized as unearned revenues.

> Universal Life-Type Contracts with Death or Other Insurance Benefit Features

30-1 A liability for unearned revenue to be recognized under paragraphs 944-605-25-5 through 25-7 and 944-605-25-9 through 25-10 shall be measured initially as the portion of such assessments that compensates the insurance entity for benefits to be provided in future periods.

30-2 For contracts in which assessments are collected over a period significantly shorter than the period for which the contract is subject to **mortality** and **morbidity** risks, the assessment would be considered a **front-end fee** and accounted for under paragraphs 944-605-25-6 through 25-7. The amounts amortized into income shall be considered assessments for purposes of this paragraph.

> Universal Life-Type Contracts

35-2 Amounts recognized as unearned revenue under paragraph 944-605-25-6 shall be recognized in income over the period benefited using the same assumptions and factors used to amortize capitalized acquisition costs under the Long-Duration Contracts Subsection of Section 944-30-35.

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Consistent with legacy US GAAP, ASU 2018-12 requires that an entity: [944-605-35-2]

- record a URR for amounts received as compensation for future services, initiation fees or front-end fees; and [944-605-25-6 – 25-7]
- amortize the URR using the same assumptions and factors used to amortize DAC.

Question 5.5.10 Is there a change to the amortization method for URR?

Interpretive response: Yes. ASU 2018-12 maintains the requirement for URR to be amortized using the same assumptions as DAC. However, the ASU modifies the DAC amortization guidance. Therefore, URR follows the simplified DAC amortization method in ASU 2018-12 (see section 4.4) and is no longer amortized using revenue or profit emergence. [944-605-35-2]

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6. Enhanced disclosure requirements

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Question 6.5.90 Does an entity need to disclose information about insignificant categories of DAC?

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6.1 How the standard works

The disclosures in ASU 2018-12 are intended to improve the decision-useful information about long-duration contracts. Entities need to disclose quantitative information in rollforwards for the liability for future policy benefits, policyholder account balances, MRBs, separate account liabilities and DAC – as well as information about the significant inputs, judgments, assumptions and methods used in measurement. [944-40-50-6 – 50-7C, 944-30-50-2A – 50-2B, 944-80-50-2, ASU 2018-12.BC93]

The new requirements introduce decision points about the level of (dis)aggregation of information to disclose. Entities may have to revisit their systems, processes and internal controls for compiling, aggregating and reviewing disclosures. [944-40-50-5A, ASU 2018-12.BC96]

The following table describes the new disclosures required by ASU 2018-12.

Disclosure	Description
Balance rollforwards for the liability for future policy benefits, policyholder account balances, MRBs, separate account liabilities and DAC.	Disaggregated tabular rollforwards reconciled to the balance sheet.
Measurement assumptions or inputs.	Information about significant inputs, judgments, assumptions and methods used in measurement, including the technique(s) used to determine unobservable discount rates.
Other items.	Information about gross premiums, gross benefits, actual deviations from expected experience, crediting rates, sales inducements, balances amortized like DAC, and the methodology and results of premium deficiency testing for certain long-duration contracts.

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6.2 Overview

Excerpt from ASC 944-30

Long-Duration Contracts

50-2A For annual reporting periods, and to the extent required by Topic 270 on interim reporting, an insurance entity shall disclose the following information about deferred acquisition costs and sales inducements:

a. The nature of the costs deferred
b. Information about the inputs, judgments, assumptions, and methods used to determine amortization amounts and changes in those inputs, judgments, and assumptions.

Pending Content

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

50-2A For interim and annual reporting periods, …

50-2B For annual and interim reporting periods, an insurance entity shall disclose the following:

a. A year-to-date disaggregated tabular rollforward of the beginning to the ending balance of unamortized deferred costs—and balances amortized on a basis consistent with deferred **acquisition costs**, to the extent that such balances are not included in the tabular rollforwards required in Section 944-40-50—disaggregated in a manner that is consistent with the disaggregation of the related liability disclosures
b. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount in the statement of financial position.

> Illustrations

• > Example 1: Disclosure of Information about Deferred Acquisition Costs

55-2 This Example illustrates the tabular rollforward that an insurance entity should disclose in its financial statements to meet the requirements of paragraph 944-30-50-2B(a).

a. Subparagraph superseded by Accounting Standards Update No. 2018-12.
b. Subparagraph superseded by Accounting Standards Update No. 2018-12.

Note X: Deferred Acquisition Costs

The balances of and changes in deferred **acquisition costs** as of and for the years ended December 31, 20X2, and December 31, 20X1, respectively, follow.

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	As of December 31, 20X2			
	Whole Life	Universal Life	Variable Universal Life	Total
Balance, beginning of year	$ YYY	$ YYY	$ YYY	$ YYY
Capitalizations	XXX	XXX	XXX	XXX
Amortization expense	(XXX)	(XXX)	(XXX)	(XXX)
Experience adjustment	(XXX)	(XXX)	(XXX)	(XXX)
Balance, end of year	$ ZZZ	$ ZZZ	$ ZZZ	$ ZZZ

	As of December 31, 20X1			
	Whole Life	Universal Life	Variable Universal Life	Total
Balance, beginning of year	$ WWW	$ WWW	$ WWW	$ WWW
Capitalizations	XXX	XXX	XXX	XXX
Amortization expense	(XXX)	(XXX)	(XXX)	(XXX)
Experience adjustment	(XXX)	(XXX)	(XXX)	(XXX)
Balance, end of year	$ YYY	$ YYY	$ YYY	$ YYY

Excerpt from ASC 944-40

Long-Duration Contracts

> Liability for Future Policy Benefits and Additional Liability for Annuitization, Death, or Other Insurance Benefits

50-6 For annual and interim reporting periods, an insurance entity shall disclose the following information about the **liability for future policy benefits** for traditional and limited-payment contracts described in paragraph 944-40-25-11 and the additional liability for annuitization, death, or other insurance benefits described in paragraphs 944-40-25-26 through 25-27A, as applicable to each of those liabilities:

a. A year-to-date disaggregated tabular rollforward of the beginning balance to the ending balance (see paragraph 944-40-55-13I). Amounts shall be presented gross of any related **reinsurance recoverable**. For the liability for future policy benefits for traditional and limited-payment contracts, the insurance entity shall present expected future **net premiums** separate from expected future benefits.
b. For each disaggregated rollforward presented, either as a component of the rollforward or as accompanying information:
    1. For traditional and limited-payment contracts, the undiscounted and discounted ending balance of expected future **gross premiums** and expected future benefits and expenses
    2. Actual experience during the period for mortality, morbidity, and lapses, compared with what was expected for the period
    3. The amount of revenue and interest recognized in the statement of operations
    4. The amount of any related reinsurance recoverable
    5. The weighted-average duration of the liability

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6. The weighted-average interest rate, a description of the technique(s) used to determine the interest rate assumption, and information about any adjustments to observable market information.

c. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount of the liability for future policy benefits and the additional liability in the statement of financial position and the total revenue and interest recognized in the statement of operations.

d. For traditional and limited-payment contracts, qualitative and quantitative information about adverse development that resulted in an immediate charge to current-period net income because of net premiums exceeding gross premiums.

50-7 For annual reporting periods, and to the extent required by Topic 270 on interim reporting, an insurance entity shall disclose information about:

a. The significant inputs, judgments, assumptions, and methods used in measuring the liability for future policy benefits and the additional liability

b. Changes in those significant inputs, judgments, and assumptions during the period, and the effect of those changes on the measurement of the liability.

Pending Content

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

50-7 For interim and annual reporting periods, …

> Liability for Policyholders' Account Balances

50-7A For annual and interim reporting periods, an insurance entity shall disclose the following information about the liability for policyholders' account balances described in paragraph 944-40-25-14 (excluding separate accounts described in paragraph 944-80-25-2):

a. A year-to-date disaggregated tabular rollforward of the beginning balance to the ending balance (see paragraph 944-40-55-13J).

b. For each disaggregated rollforward:
   1. The weighted-average crediting rate
   2. The guaranteed benefit amounts in excess of the current account balances
   3. **Cash surrender value**.

c. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount of the liability for policyholders' account balances in the statement of financial position.

d. A tabular presentation of policyholders' account balances by range of guaranteed minimum crediting rates and the related range of the difference between rates being credited to policyholders and the respective guaranteed minimums.

> Market Risk Benefits

50-7B For annual and interim reporting periods, an insurance entity shall disclose the following information about **market risk benefits**:

a. A year-to-date disaggregated tabular rollforward of the beginning balance to the ending balance (see paragraph 944-40-55-13K)

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b. For each disaggregated rollforward, the guaranteed benefit amounts in excess of the current account balances (for example, the **net amount at risk**) and weighted-average attained age of contract holders
c. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount in the statement of financial position, disaggregated between market risk benefits that are in an asset position and those that are in a liability position.

50-7C For annual reporting periods, and to the extent required by Topic 270 on interim reporting, an insurance entity shall disclose information about:

a. The significant inputs, judgments, assumptions, and methods used in measurement
b. Changes in those significant inputs, judgments, and assumptions during the period and the effect of those changes on the measurement of market risk benefits.

Pending Content

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

50-7C For interim and annual reporting periods, …

> Implementation Guidance

• > Disclosures

55-13I The tabular rollforward of the beginning to the ending balance related to the liability for future policy benefits or the additional liability as required in paragraph 944-40-50-6 could include the following line items:

a. Issuances
b. Interest accrual
c. Net premiums or assessments collected
d. Benefit payments
e. Derecognition (lapses or withdrawals)
f. Effect of actual variances from expected experience
g. Effect of changes in cash flow assumptions
h. Effect of changes in discount rate assumptions.

55-13J The tabular rollforward of the beginning to the ending balance related to the liability for policyholders' account balances as required in paragraph 944-40-50-7A could include the following line items:

a. Issuances
b. Premiums received
c. Policy charges
d. Surrenders and withdrawals
e. Benefit payments
f. Transfers from or to separate accounts
g. Interest credited.

55-13K The tabular rollforward of the beginning to the ending balance related to market risk benefits as required in paragraph 944-40-50-7B could include the following line items:

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a. Issuances
b. Interest accrual
c. Attributed fees collected
d. Benefit payments
e. Effect of changes in interest rates
f. Effect of changes in equity markets
g. Effect of changes in equity index volatility
h. Actual policyholder behavior different from expected behavior
i. Effect of changes in future expected policyholder behavior
j. Effect of changes in other future expected assumptions
k. Effect of changes in the instrument-specific credit risk.

To the extent that the tabular rollforward of the beginning to the ending balance related to market risk benefits achieves the fair value disclosure requirements described in Section 820-10-50, an insurance entity need not duplicate the related fair value disclosure.

> Illustrations

• > Example 3: Disclosure of Information about the Liability for Future Policy Benefits

55-29E This Example illustrates the information that an insurance entity with two major long-duration product lines (term life and whole life) should disclose in its 20X2 financial statements to meet certain requirements of paragraph 944-40-50-6.

Note X: Liability for Future Policy Benefits

The balances of and changes in the liability for future policy benefits follow.

		December 31,			
		20X2		20X1	
		Term Life	Whole Life	Term Life	Whole Life
Present Value of Expected Net Premiums	Balance, beginning of year	.$ VVV	$ VVV	$ XXX	$ XXX
	Beginning balance at original discount rate	$ WWW	WWW	XXX	XXX
	Effect of changes in cash flow assumptions	XXX	XXX	XXX	XXX
	Effect of actual variances from expected experience	XXX	XXX	XXX	XXX
	Adjusted beginning of year balance	XXX	XXX	XXX	XXX
	Issuances	XXX	XXX	XXX	XXX
	Interest accrual	XXX	XXX	XXX	XXX
	Net premiums collected[(a)]	(XXX)	(XXX)	(XXX)	(XXX)
	Derecognition (lapses)	(XXX)	(XXX)	(XXX)	(XXX)
	Ending balance at original discount rate	YYY	YYY	WWW	WWW
	Effect of changes in discount rate assumptions	XXX	XXX	XXX	XXX
	Balance, end of year	$ ZZZ	$ ZZZ	$ VVV	$ VVV

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		December 31,			
		20X2		20X1	
		Term Life	Whole Life	Term Life	Whole Life
Present Value of Expected Future Policy Benefits	Balance, beginning of year	$ VVV	$ VVV	$ XXX	$ XXX
	Beginning balance at original discount rate	$ WWW	WWW	XXX	XXX
	Effect of changes in cash flow assumptions	XXX	XXX	XXX	XXX
	Effect of actual variances from expected experience	XXX	XXX	XXX	XXX
	Adjusted beginning of year balance	XXX	XXX	XXX	XXX
	Issuances	XXX	XXX	XXX	XXX
	Interest accrual	XXX	XXX	XXX	XXX
	Benefit payments	(XXX)	(XXX)	(XXX)	(XXX)
	Derecognition (lapses)	(XXX)	(XXX)	(XXX)	(XXX)
	Ending balance at original discount rate	YYY	YYY	WWW	WWW
	Effect of changes in discount rate assumptions	XXX	XXX	XXX	XXX
	Balance, end of year	$ ZZZ	$ ZZZ	$ VVV	$ VVV
	Net liability for future policy benefits	$ CCC	$ DDD	$ AAA	$ BBB
	Less: Reinsurance recoverable	XXX	XXX	XXX	XXX
	Net liability for future policy benefits, after reinsurance recoverable	$ XXX	$ XXX	$ XXX	$ XXX

a. Net premiums collected represent the portion of gross premiums collected from policyholders that is used to fund expected benefit payments.

The reconciliation of the net liability for future policy benefits to the liability for future policy benefits in the consolidated statement of financial position follows.

	December 31,	
	20X2	20X1
Term life	$ CCC	$ AAA
Whole life	DDD	BBB
Other	XXX	XXX
Total	$ XXX	$ XXX

The amount of undiscounted expected gross premiums and expected future benefit payments follows.

	December 31,	
	20X2	20X1
Term life		
Expected future benefit payments	$ XXX	$ XXX

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Expected future gross premiums	$ XXX	$ XXX
Whole life		
Expected future benefit payments	$ XXX	$ XXX
Expected future gross premiums	$ XXX	$ XXX

The amount of revenue and interest recognized in the statement of operations follows.

	Gross Premiums or Assessments		Interest Expense	
	December 31,		December 31,	
	20X2	20X1	20X2	20X1
Term life	$ XXX	$ XXX	$ XXX	$ XXX
Whole life	XXX	XXX	XXX	XXX
Other	XXX	XXX	XXX	XXX
Total	$ XXX	$ XXX	$ XXX	$ XXX

The weighted-average interest rate follows.

	December 31,	
	20X2	20X1
Term life		
Interest accretion rate	XXX%	XXX%
Current discount rate	XXX%	XXX%
Whole life		
Interest accretion rate	XXX%	XXX%
Current discount rate	XXX%	XXX%

• > Example 4: Disclosure of Information about the Liability for Policyholders' Account Balances

55-29F This Example illustrates the information that an insurance entity with two major long-duration products with policyholders' account balances (universal life and fixed annuities) should disclose in its 20X2 financial statements to meet certain requirements of paragraph 944-40-50-7A.

Note X: Policyholders' Account Balances

The balance of account values by range of guaranteed minimum crediting rates and the related range of difference, in basis points, between rates being credited to policyholders and the respective guaranteed minimums follow.

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		December 31, 20X2				
	Range of Guaranteed Minimum Crediting Rate	At Guaranteed Minimum	1 Basis Point–50 Basis Points Above	51 Basis Points–150 Basis Points Above	Greater Than 150 Basis Points Above	Total
Universal Life	X.XX%–X.XX%	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
	X.XX%–X.XX%	XXX	XXX	XXX	XXX	XXX
	Greater than X.XX%	XXX	XXX	XXX	XXX	XXX
	Total	$ XXX	$ XXX	$ XXX	$ XXX	$ CCC
Fixed Annuity	X.XX%–X.XX%	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
	X.XX%–X.XX%	XXX	XXX	XXX	XXX	XXX
	Greater than X.XX%	XXX	XXX	XXX	XXX	XXX
	Total	$ XXX	$ XXX	$ XXX	$ XXX	$ DDD

		December 31, 20X1				
	Range of Guaranteed Minimum Crediting Rate	At Guaranteed Minimum	1 Basis Point–50 Basis Points Above	51 Basis Points–150 Basis Points Above	Greater Than 150 Basis Points Above	Total
Universal Life	X.XX%–X.XX%	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
	X.XX%–X.XX%	XXX	XXX	XXX	XXX	XXX
	Greater than X.XX%	XXX	XXX	XXX	XXX	XXX
	Total	$ XXX	$ XXX	$ XXX	$ XXX	$ AAA
Fixed Annuity	X.XX%–X.XX%	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
	X.XX%–X.XX%	XXX	XXX	XXX	XXX	XXX
	Greater than X.XX%	XXX	XXX	XXX	XXX	XXX
	Total	$ XXX	$ XXX	$ XXX	$ XXX	$ BBB

The balances of and changes in policyholders' account balances follow.

	December 31,			
	20X2		20X1	
	Universal Life	Fixed Annuity	Universal Life	Fixed Annuity
Balance, beginning of year	$ AAA	$ BBB	$ XXX	$ XXX
Issuances	XXX	XXX	XXX	XXX
Premiums received	XXX	XXX	XXX	XXX
Policy charges [a]	(XXX)	(XXX)	(XXX)	(XXX)
Surrenders and withdrawals	(XXX)	(XXX)	(XXX)	(XXX)
Benefit payments	(XXX)	(XXX)	(XXX)	(XXX)
Net transfers from (to) separate account	XXX	XXX	XXX	XXX
Interest credited	XXX	XXX	XXX	XXX
Other	XXX	XXX	XXX	XXX
Balance, end of year	$ CCC	$ DDD	$ AAA	$ BBB
Weighted-average crediting rate	X.XX%	X.XX%	X.XX%	X.XX%
Net amount at risk [b]	$ XXX	$ XXX	$ XXX	$ XXX
Cash surrender value	$ XXX	$ XXX	$ XXX	$ XXX

a. Contracts included in the policyholder account balances are generally charged a premium and/or monthly assessments on the basis of the account balance.

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b. For those guarantees of benefits that are payable in the event of death, the net amount at risk is generally defined as the current guaranteed minimum death benefit in excess of the current account balance at the balance sheet date.

The reconciliation of policyholders' account balances to the policyholders' account balances' liability in the consolidated statement of financial position follows.

	December 31,	
	20X2	20X1
Universal life	$ CCC	$ AAA
Fixed annuity	DDD	BBB
Other	XXX	XXX
Total	$ XXX	$ XXX

• > Example 5: Disclosure of Information about Market Risk Benefits

55-29G This Example illustrates the information that an insurance entity with market risk benefits should disclose in its 20X2 financial statements to meet certain requirements of paragraph 944-40-50-7B.

Note X: Market Risk Benefits

The balances of and changes in guaranteed minimum withdrawal benefits associated with variable annuities and indexed annuities follow.

	December 31, 20X2		December 31, 20X1	
	Variable Annuities	Indexed Annuities	Variable Annuities	Indexed Annuities
Balance, beginning of year	$ AAA	$ FFF	$ XXX	$ XXX
Balance, beginning of year, before effect of changes in the instrument-specific credit risk	XXX	XXX	XXX	XXX
Issuances	XXX	XXX	XXX	XXX
Interest accrual	XXX	XXX	XXX	XXX
Attributed fees collected	XXX	XXX	XXX	XXX
Benefit payments	(XXX)	(XXX)	(XXX)	(XXX)
Effect of changes in interest rates	XXX	XXX	XXX	XXX
Effect of changes in equity markets	XXX	XXX	XXX	XXX
Effect of changes in equity index volatility	XXX	XXX	XXX	XXX
Actual policyholder behavior different from expected behavior	XXX	XXX	XXX	XXX
Effect of changes in future expected policyholder behavior	XXX	XXX	XXX	XXX
Effect of changes in other future expected assumptions	XXX	XXX	XXX	XXX
Balance, end of year, before effect of changes in the instrument-specific credit risk	XXX	XXX	XXX	XXX
Effect of changes in the instrument-specific credit risk	XXX	XXX	XXX	XXX
Balance, end of year	$ GGG	$ LLL	$ AAA	$ FFF
Reinsurance recoverable, end of year	$ XXX	$ XXX	$ XXX	$ XXX
Balance, end of year, net of reinsurance	$ XXX	$ XXX	$ XXX	$ XXX

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The reconciliation of market risk benefits by amounts in an asset position and in a liability position to the market risk benefits amount in the consolidated statement of financial position follows.

	December 31,					
	20X2			20X1		
	Asset	Liability	Net	Asset	Liability	Net
Variable annuities	$ XXX	$ XXX	$ GGG	$ XXX	$ XXX	$ AAA
Indexed annuities	XXX	XXX	LLL	XXX	XXX	FFF
	$ XXX	$ XXX	$ NNN	$ XXX	$ XXX	$ MMM

Excerpt from ASC 944-80

General

50-1 The following information shall be disclosed in the financial statements of the insurance entity:

a. The general nature of the contracts reported in separate accounts, including the extent and terms of minimum guarantees (including **market risk benefits**)
b. The basis of presentation for both of the following:
   1. **Separate account** assets and liabilities
   2. Related separate account activity.
c. Subparagraph superseded by Accounting Standards Update No. 2018-12.
d. Subparagraph superseded by Accounting Standards Update No. 2018-12.
e. The aggregate **fair value** of assets, by major investment asset category, supporting separate accounts as of each date for which a statement of financial position is presented
f. The amount of gains and losses recognized on assets transferred to separate accounts for the periods presented.

Pending Content

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

50-1 The following information shall be disclosed in the interim and annual financial statements …

50-2 For annual and interim reporting periods, an insurance entity shall disclose the following information about separate account liabilities described in paragraph 944-80-25-2:

a. A year-to-date disaggregated tabular rollforward of the beginning balance to the ending balance disaggregated in accordance with paragraph 944-40-50-5A
b. For each separate account liability rollforward presented, the related **cash surrender values**

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c. A reconciliation of the separate account liability rollforwards to the aggregated ending carrying amount of the liability in the statement of financial position.

ASU 2018-12 requires expanded disclosures for annual and interim reporting periods to allow users to understand the amount, timing and uncertainty of cash flows related to long-duration contracts. The disclosure changes introduce a principle for determining how to (dis)aggregate the new disclosures. The FASB's intention is to provide meaningful information without including a large amount of insignificant detail or aggregating items with significantly different characteristics. [944-40-50-5A, ASU 2018-12.BC96]

Observation Challenges to the financial reporting timeline

Entities will be required to determine whether they need new financial data, and whether they should update their processes and internal controls to manage the expanded disclosures. They will also need to determine what level of (dis)aggregation should be used for the disclosures.

The additional work for the expanded disclosures will need to be considered when planning the financial reporting timeline.

6.3 Requirements for annual and interim reporting periods

ASU 2018-12 requires year-to-date disaggregated tabular rollforward disclosures for certain assets and liabilities related to long-duration contracts as well as qualitative information. The tables summarize the required disclosures for annual and interim reporting periods.

Liability for future policy benefits[1]	Liability for policyholders' account balances[2, 3]	Market risk benefits
Year-to-date disaggregated tabular rollforward of the beginning balance to the …		
… ending balance with separate presentation of expected future net premiums and benefits. [944-40-50-6(a)]	… ending balance. [944-40-50-7A(a)]	… ending balance. [944-40-50-7B(a)]
Each disaggregated rollforward includes the …		
… following information either as a component of the rollforward or as accompanying information: [944-40-50-6(b)] • undiscounted and discounted ending	• weighted-average crediting rate; • guaranteed benefit amounts in excess of the current account balances; and	• guaranteed benefit amounts in excess of the current account balances; and • weighted-average attained age of

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Liability for future policy benefits[1]	Liability for policyholders' account balances[2, 3]	Market risk benefits
balance of expected future gross premiums and expected future benefits and expenses; • actual experience compared to expected for the period for: — mortality; — morbidity; and — lapses; • revenue and interest recognized in the income statement; • reinsurance recoverable; • weighted-average duration of the liability; and • weighted-average interest rate.[4]	• cash surrender value. [944-40-50-7A(b)]	contract holders. [944-40-50-7B(b)]
Qualitative and quantitative information about …		
… adverse development for traditional and limited-payment contracts that resulted in an immediate charge to current-period net income because of net premiums exceeding gross premiums. [944-40-50-6(d)]	No specific requirements.	No specific requirements.
Reconciliation of disaggregated rollforwards to the aggregate ending carrying amount …		
… of the liability for future policy benefits, additional liability and total revenue and interest recognized in the period in the income statement. [944-40-50-6(c)]	… of the liability. [944-40-50-7A(c)]	… disaggregated between asset and liability positions. [944-40-50-7B(c)]

Notes:

1. Disclosure requirements are for traditional and limited-payment contracts and the additional liability for annuitization, death or other insurance benefits. [944-40-50-6]
2. Disclosure requirements for liabilities for policyholders' account balances exclude separate accounts described in paragraph 944-80-25-2. [944-40-50-7A]
3. Additional disclosure requirements include a tabular presentation of policyholders' account balances by range of guaranteed minimum crediting rates, and the related range of differences between rates being credited to policyholders and the respective guaranteed minimums. [944-40-50-7A(d)]

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4. Including a description of the technique(s) used to determine the interest rate assumption, and information about any adjustments to observable market information. [944-40-50-6(b)(6)]

The following table summarizes the required disclosures for annual and interim reporting periods for DAC and separate accounts.

Deferred acquisition costs[1]	Separate accounts[2]
Disaggregated tabular rollforward of the beginning balance to the …	
… ending balance. [944-30-50-2B(a)]	… ending balance of liability. [944-80-50-2]
Disaggregated rollforward …	
… is consistent with the (dis)aggregation of the related liability disclosures and reconciled to the aggregated ending carrying amount of the asset. [944-30-50-2B(a) – 50-2B(b)]	… includes the cash surrender value and a reconciliation to the aggregated ending carrying amount of the liability. [944-80-50-2(b) – 50-2(c)]
Additional disclosures	
No additional disclosures for annual or interim reporting periods.	These disclosures apply to separate account assets and liabilities: [944-80-50-1] • general nature of the contracts reported in separate accounts; • extent and terms of minimum guarantees (including MRBs); • basis for presentation of separate account assets and liabilities and the related activity; • aggregate fair value of assets, by major investment asset category, supporting separate accounts as of each date for which a balance sheet is presented; and • amounts of gains and losses recognized on assets transferred to separate accounts for the periods presented.
Notes: 1. Also applies to sales inducements and other balances amortized on a basis consistent with DAC. 2. Disclosure requirements apply to separate accounts meeting the conditions in 944-80-25-2. [944-80-50-2]	

Question 6.3.10 Can an entity net the activity disclosed in the tabular rollforward of the liability for future policy benefits with reinsurance?

Interpretive response: No. An entity presents amounts gross of any related reinsurance recoverable in the year-to-date tabular rollforward of the beginning

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balance to the ending balance of the liability for future policy benefits. Amounts for reinsurance are presented either as a separate component of the rollforward or as accompanying information. This guidance also applies to the additional liability for annuitization, death or other insurance benefits. [944-40-50-6(a) – 50-6(b)]

Question 6.3.20 Does an entity disclose a tabular rollforward for future policy benefits and MRBs when its direct business is 100% reinsured?

Interpretive response: Yes. An entity discloses the tabular rollforward even if the balances are 100% reinsured. [944-40-50-6]

Question 6.3.30 Does an entity disclose a tabular rollforward of the deferred profit liability on limited-payment contracts?

Interpretive response: It depends. Topic 944 does not require a separate tabular rollforward of the deferred profit liability on limited-payment contracts.

However, if an entity presents its deferred profit liability within its liability for future policy benefits financial statement caption, it has to decide how to disclose the changes in the deferred profit liability within the liability for future policy benefits rollforward. It could decide to present: [944-40-50-6 – 50-7]

- the deferred profit liability as a reconciling item from the tabular rollforward to the liability for future policy benefits line item; or
- a separate rollforward of the deferred profit liability with the components reflective of the unique characteristics of the deferred profit liability.

Entities will need to apply judgment to determine which disclosure of the deferred profit liability provides users with meaningful information.

Question 6.3.40 How does an entity disclose the difference between actual and expected premium and policy benefit experience within the rollforward?

Interpretive response: An entity presents a year-to-date disaggregated tabular rollforward of the beginning balance to the ending balance of the liability for future policy benefits for traditional and limited-payment contracts. [944-40-50-6(a)]

Update to net premium ratio

Subtopic 944-40 Example 3 illustrates one approach to presenting the disaggregated tabular rollforward. In a period when an entity updates its net premium ratio, the resulting year-to-date remeasurement gain (loss) is presented within the 'Effect of changes in cash flow assumptions' and 'Effect of actual variances from expected experience' line items. These line items are

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combined with the 'Beginning balance at original discount rate' to determine the 'Adjusted beginning of year balance' separately for net premiums and policy benefits.

No update to net premium ratio

In a period when an entity does not update its net premium ratio, there is no resulting change to the 'Effect of changes in cash flow assumptions' and 'Effect of actual variances from expected experience' line items within the rollforward. However, for each disaggregated liability for future policy benefits rollforward, an entity discloses actual experience during the period for mortality, morbidity and lapses as compared to expected experience for the period. Because we believe that the entity calculates the liability for future policy benefits using updated insurance in force – e.g. updated for lapses and mortality, it presents actual premium and policy benefit information for the period in the rollforward.

This information is presented in the 'Issuances', 'Interest accrual', 'Net premiums collected', 'Benefit payments' and 'Derecognition (lapses)' line items within the net premiums and policy benefits sections of the rollforward. In these periods, the difference between the actual amounts and the expected amounts can be reflected in separate line items within the net premiums and policy benefits sections of the rollforward – e.g. as an 'experience variance' line item.

For guidance on updating cash flow assumptions, see section 2.3.10. For guidance on updating for actual experience, see section 2.3.20. For guidance on disclosing actuals to expected as accompanying information, see Question 6.3.50.

Question 6.3.50 How does an entity disclose actual mortality, morbidity and lapse experience during the period as compared to expected as accompanying information?

Interpretive response: For each disaggregated liability for future policy benefits rollforward, an entity discloses actual experience during the period for mortality, morbidity and lapses as compared to expected experience for the period. ASU 2018-12 does not prescribe the format for disclosure other than that it may be presented as a component of the rollforward or as accompanying information. [944-40-50-6(b)(2)]

An entity determines how to provide decision-useful information when presented as accompanying information, which could include disclosing the:

- percentage of actual to expected experience during the period;
- numerical difference between actual and expected experience during the period;
- actual experience and expected experience separately.

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Question 6.3.60 How does an entity disclose a ceding commission that represents the recovery of acquisition costs within the rollforward?

Interpretive response: When a ceding entity enters into a reinsurance contract, it may receive consideration from the reinsurer that represents the recovery of acquisition costs. Generally, this is in the form of a ceding commission. If the ceding commission received represents a recovery of unamortized acquisition costs, the ceding entity records it as a reduction of the unamortized acquisition costs. As a result, the entity records the DAC balance in its financial statements net of any ceding commission received that represents the recovery of acquisition costs. [944-30-35-64]

Further, an entity is required to disclose a year-to-date disaggregated tabular rollforward of the beginning to the ending balance of unamortized deferred costs recorded in the financial statements. This disaggregated tabular rollforward is presented gross of reinsurance. In the initial period the ceding commission received (recovery of acquisition costs) is recorded, it is included in the disaggregated tabular rollforward on a gross basis so that the rollforward reconciles to the DAC balance recorded in the financial statements. Topic 944 does not specify the line items to be included in the reconciliation or how an entity includes the ceding commission received (recovery of acquisition costs). Therefore, we believe an entity includes a separate line item for that reporting period to specifically disclose the amount. [944-30-50-2B(b), 55-2]

6.4 Requirements for annual reporting periods only

In addition to the disclosures required for annual and interim reporting periods, additional disclosure requirements apply to annual reporting periods. Separate accounts and the liability for policyholder account balances do not have these additional disclosures. The following disclosures also may apply to interim reporting periods to the extent they are required by Topic 270.

Liability for future policy benefits	Market risk benefits	Deferred acquisition costs[1]
Qualitative and quantitative information about the …		
• significant inputs, judgments, assumptions and methods used in measuring the liability; and • changes to these items during the period, and the effect of those changes on measurement. [944-40-50-7]	• significant inputs, judgments, assumptions and methods used in measurement; and • changes to these items during the period, and the effect of those changes on measurement. [944-40-50-7C]	• nature of costs deferred; • inputs, judgments, assumptions, and methods used to determine amortization; and • changes in those inputs, judgments and assumptions. [944-30-50-2A]

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Note:

1. Also applies to sales inducements and other balances amortized on a basis consistent with DAC.

6.5 (Dis)aggregation of disclosures

Excerpt from ASC 944-40

Long-Duration Contracts

50-5A An insurance entity shall disclose the information required by paragraphs 944-40-50-6 through 50-7C in a manner that allows users to understand the amount, timing, and uncertainty of future cash flows arising from the liabilities. An insurance entity shall aggregate or disaggregate the disclosures in paragraphs 944-40-50-6 through 50-7C so that useful information is not obscured by the inclusion of a large amount of insignificant detail or by the aggregation of items that have significantly different characteristics (see paragraphs 944-40-55-13F through 55-13H). An insurance entity need not provide disclosures about liabilities for insignificant categories; however, balances for insignificant categories shall be included in the reconciliations.

> Implementation Guidance

• > Disclosures

55-13F To allow financial statement users to understand the amount, timing, and uncertainty of cash flows arising from contracts issued by insurance entities, paragraph 944-40-50-5A requires that an insurance entity aggregate or disaggregate certain disclosures so that useful information is not obscured by the inclusion of a large amount of insignificant detail or by the aggregation of items that have significantly different characteristics. Consequently, the extent to which an insurance entity's information is aggregated or disaggregated for the purpose of those disclosures depends on the facts and circumstances that pertain to the characteristics of the liability for future policy benefits, the additional liability, the liability for policyholders' account balances, **separate account** liabilities, **market risk benefits**, or deferred **acquisition costs** (and balances amortized on a basis consistent with deferred acquisition costs).

55-13G In addition, when selecting the type of category to use to aggregate or disaggregate disclosures, an insurance entity should consider how information about the disclosed items has been presented for other purposes, including the following:

a. Disclosures presented outside the financial statements (for example, in statutory filings)
b. Information regularly viewed by the chief operating decision maker for evaluating financial performance
c. Other information that is similar to the types of information identified in (a) and (b) and that is used by the insurance entity or users of the insurance entity's financial statements to evaluate the insurance entity's financial performance or make resource allocation decisions.

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55-13H Examples of categories that might be appropriate to consider to aggregate or disaggregate disclosures include the following:

a. Type of coverage (for example, major product line)
b. Geography (for example, country or region)
c. Market or type of customer (for example, individual or group lines of business).

When applying the guidance in paragraphs 944-30-50-2A through 50-2B, 944-40-50-6 through 50-7C, and 944-80-50-1 through 50-2, an insurance entity should not aggregate amounts from different reportable segments according to Topic 280, if applicable.

Entities will need to apply judgment in (dis)aggregating the information to provide meaningful disclosure in the notes to the financial statements.

Question 6.5.10 Does an entity revisit its (dis)aggregation conclusion for disclosures after adopting ASU 2018-12?

Interpretive response: Yes. Determining the appropriate (dis)aggregation depends on the entity's facts and circumstances. We believe an entity's (dis)aggregation conclusions for disclosures will change when the facts and circumstances indicate that a change is appropriate. The (dis)aggregation decision cannot be 'locked in' with the adoption of ASU 2018-12.

Further, we believe the SEC will expect an entity to reevaluate the (dis)aggregation conclusions for disclosures on an annual basis. This view is consistent with comment letters issued by the SEC related to short-duration disclosures required by paragraphs 944-40-50-3 to 50-5; the (dis)aggregation disclosure principle is the same for short- and long-duration contracts. [944-40-50-5A]

Question 6.5.20 What should management consider when determining the level of (dis)aggregation?

Interpretive response: Management should consider how it uses information for other purposes, such as how information is: [944-40-55-13G]

- disclosed in statutory filings;
- viewed by the chief operating decision maker for evaluating the entity's performance;
- reported internally for performance evaluation;
- included in investor presentations;
- reported in earnings releases; and
- provided to analysts.

An assessment of items like these will help inform an entity about decision-useful information to disclose.

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Question 6.5.30 Can an entity aggregate amounts from different reportable segments?

Interpretive response: No. An entity cannot aggregate amounts from different reportable segments when preparing the required disclosures. [944-40-55-13H]

Question 6.5.40 What categories should management consider when determining the level of (dis)aggregation?

Interpretive response: Management should consider the types of contracts when determining the level of (dis)aggregation of its disclosures. An entity may issue contracts with different types of coverage and may have a variety of product lines. Geography, such as a region, may also be used to assess its business. An entity may also consider the market or type of customer, such as individual or group lines of business. However, amounts from different reportable segments should not be aggregated (see Question 6.5.30). [944-40-55-13H]

Question 6.5.50 Will the SEC expect consistency between MD&A and the notes to the financial statements?

Interpretive response: Yes, we believe so. The SEC issued several comment letters to insurance entities about their disclosures for short-duration contracts under paragraphs 944-40-50-3 to 50-5. The SEC observed discrepancies between the discussions in MD&A and the notes to the financial statements.

We believe the SEC will also expect consistency between discussions in MD&A and the disclosures in the notes for long-duration contracts.

Question 6.5.60 What level of detail is required for disclosures about inputs, judgments, assumptions and methods used?

Interpretive response: Management should consider the same factors discussed in Questions 6.5.10 to 6.5.50. The same principle of providing information that allows users to understand the amount, timing and uncertainty in cash flows applies to these disclosures. [944-40-50-5A]

Question 6.5.70 Is the level of (dis)aggregation the same for the liability for future policy benefits and DAC?

Interpretive response: Yes. An entity groups contracts for DAC disclosures consistent with the (dis)aggregation of the related liability for future policy

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benefits disclosures. For guidance on the measurement of grouped contracts for DAC amortization, see section 4.4.20. [944-30-50-2B(a)]

Question 6.5.80 Does an entity need to disclose information about insignificant categories of liability?

Interpretive response: No. An entity does not need to provide disclosures for insignificant categories of the liability for future policy benefits and the additional liability for annuitization, death or other insurance benefits. However, the sum of amounts related to insignificant categories should be included in the disclosure to allow for reconciliation of the amounts disclosed to the amount recognized in the financial statements. [944-40-50-5A]

Question 6.5.90 Does an entity need to disclose information about insignificant categories of DAC?

Interpretive response: Significance is not specifically addressed in the DAC disclosure requirements. Because DAC disclosure (dis)aggregation needs to be consistent with the related liability for future policy benefits, we believe an entity should follow the same disclosure approach as the liability for future policy benefits. The sum of amounts related to insignificant DAC categories should be included in the reconciliation of the amounts disclosed to the amount recognized in the financial statements. [944-30-50-2A – 50-2B(a)]

Question 6.5.100 Is the rollforward for the additional liability for annuitization, death or other insurance benefits separate from the liability for future policy benefits?

Interpretive response: Yes. An entity prepares a tabular rollforward for the additional liability for annuitization, death or other insurance benefits separate from the rollforward for the liability for future policy benefits.

The rollforward for the additional liability for annuitization, death or other insurance benefits follows the same (dis)aggregation principles as discussed in Questions 6.5.10 to 6.5.50. [944-40-50-5A, 50-6, 55-13I]

Question 6.5.110 Is a separate rollforward table required for each type of MRB offered by an entity?

Interpretive response: Generally, yes. The (dis)aggregation disclosure principle for the liability for future policy benefits also applies to MRBs. If an entity offers multiple types of MRBs, a separate rollforward is disclosed, unless a type of MRB is insignificant. The total amount of insignificant MRB types is included in

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the reconciliation of the rollforward(s) to the amount(s) on the balance sheet. [944-40-50-7B]

For example, an entity issues variable annuity contracts and offers GLWB and GMIB. The entity's variable annuities could include one or both of these benefits.

The entity discloses separate rollforward tables for contracts with:

- only GLWB;
- only GMIB; and
- both GLWB and GMIB (compound MRBs).

If an entity issues fixed annuity contracts with GLWB – in addition to variable annuities with GLWB and GMIB – we believe, separate columns are included in the GLWB benefits table to separately disclose the fixed and variable contracts in the rollforward table.

Alternatively, an entity could include a table for the fixed annuity contracts with GLWB separate from the variable annuity contracts.

Amounts in different reportable segments cannot be aggregated in the tables (see Question 6.5.30).

For guidance on contracts and contract features that meet the definition of MRBs, see section 3.3.

Question 6.5.120 Is the (dis)aggregation relevant for reinsurance?

Interpretive response: Yes. One of the required disclosures for each disaggregated rollforward presented is the amount of any related reinsurance recoverables. Therefore reinsurance recoverables need to be (dis)aggregated at the same level as the presented rollforward tables. [944-40-50-6]

For guidance on disclosing reinsurance, see Questions 6.3.10 and 6.3.20.

6.6 Other disclosure considerations

Excerpt from ASC 944-60

Long-Duration Contracts

50-2 For annual reporting periods, and to the extent required by Topic 270 on interim reporting, an insurance entity shall disclose the following:

a. The amount of a liability that is established as a result of a premium deficiency and loss recognition testing determined in accordance with paragraphs 944-60-25-7 through 25-9 and a description of the factors that led to the establishment of the liability
b. Information about the methodology used when performing premium deficiency testing in accordance with paragraphs 944-60-25-7 through 25-9

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c. Whether the entity considered anticipated investment income when performing premium deficiency testing in accordance with paragraphs 944-60-25-7 through 25-9 and if so, what that assumption was.

Pending Content

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

50-2 For interim and annual reporting periods, …

Excerpt from ASC 944-805

Demutualizations

50-3 An insurance entity that has formed a closed block shall disclose both of the following:

a. A general description of the closed block, including all of the following:
   1. The purpose of the closed block
   2. The types of insurance policies included
   3. The nature of the cash flows that increase and decrease the amount of closed block assets and liabilities
   4. An indication of the continuing responsibility of the insurance entity to support the payment of contractual benefits, including the results of premium sufficiency or deficiency determined in accordance with paragraphs 944-60-25-7 through 25-9
   5. The nature of expenses charged to the closed block operations.
b. Summarized financial data of the closed block as of, or for periods ending on the date of, the financial statements presented, which shall include, at a minimum, all of the following:
   1. The carrying amounts for the major types of invested assets of the closed block
   2. Future policy benefits and policyholders' account balances
   3. Policyholder dividend obligation
   4. Premiums
   5. Net investment income
   6. Realized investment gains and losses
   7. Policyholder benefits
   8. Policyholder dividends
   9. The amount of maximum future earnings remaining to inure to the benefit of stockholders from the assets and liabilities of the closed block
   10. An analysis of the changes in the policyholder dividend obligation.

> Illustrations

• > Example 2: Disclosure of a Closed Block

55-3 This Example illustrates one application of the disclosure requirements of the Demutualizations Subsection of Section 944-805-50 for a single hypothetical insurance entity, referred to as ABC Life Insurance Entity. ABC Life Insurance Entity would make the following disclosures.

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At the effective date (January XX, 20X1) of the Plan of Demutualization, eligible policyholders received, in the aggregate, approximately $XX million of cash, $XX million of policy credits, and XX million shares of common stock of ABC Holding Entity in exchange for their membership interests in ABC Life Insurance Entity. The demutualization was accounted for as a reorganization. Accordingly, ABC Life Insurance Entity's retained earnings at the Plan Effective Date (net of the aforementioned cash payments and policy credits, which were charged directly to retained earnings) were reclassified to common stock and capital in excess of par.

As of January XX, 20X1, ABC Life Insurance Entity established a closed block for the benefit of certain classes of individual participating policies for which ABC Life Insurance Entity had a dividend scale payable in 20X0 and that were in force on January XX, 20X1. Assets were allocated to the closed block in an amount that, together with anticipated revenues from policies included in the closed block, was reasonably expected to be sufficient to support such business, including provision for payment of benefits, certain expenses, and taxes, and for continuation of dividend scales payable in 20X0, assuming experience underlying such scales continues. Assets allocated to the closed block inure solely to the benefit of the holders of the policies included in the closed block and will not revert to the benefit of stockholders of ABC Life Insurance Entity. No reallocation, transfer, borrowing, or lending of assets can be made between the closed block and other portions of ABC Life Insurance Entity's general account, any of its separate accounts, or any affiliate of ABC Life Insurance Entity without the approval of the Z State Insurance Department.

If, over time, the aggregate performance of the closed block assets and policies is better than was assumed in funding the closed block, dividends to policyholders will be increased. If, over time, the aggregate performance of the closed block assets and policies is less favorable than was assumed in the funding, dividends to policyholders could be reduced.

The assets and liabilities allocated to the closed block are recognized in ABC Life Insurance Entity's financial statements on the same basis as other similar assets and liabilities. The carrying amount of closed block liabilities in excess of the carrying amount of closed block assets at the date of demutualization (adjusted to eliminate the effect of related amounts in accumulated other comprehensive income) represents the maximum future earnings from the assets and liabilities designated to the closed block that can be recognized in income over the period the policies in the closed block remain in force. ABC Life Insurance Entity has developed an actuarial calculation of the timing of such maximum future stockholder earnings, and this is the basis of the policyholder dividend obligation.

If actual cumulative earnings are greater than expected cumulative earnings, only expected earnings will be recognized in income. Actual cumulative earnings in excess of expected cumulative earnings represents undistributed accumulated earnings attributable to policyholders, which are recognized as a policyholder dividend obligation because the excess will be paid to closed block policyholders as an additional policyholder dividend unless otherwise offset by future performance of the closed block that is less favorable than originally expected. If actual cumulative performance is

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less favorable than expected, only actual earnings will be recognized in income.

The principal cash flow items that affect the amount of closed block assets and liabilities are premiums, net investment income, purchases and sales of investments, policyholders' benefits, policyholder dividends, premium taxes, and income taxes. The principal income and expense items excluded from the closed block are management and maintenance expenses, commissions and net investment income, and realized investment gains and losses of investment assets outside the closed block that support the closed block business. The amounts shown in the following tables for assets, liabilities, revenues, and expenses of the closed block are those that enter into the determination of amounts that are to be paid to policyholders.

• > Example 3: Closed Block Accounting

55-6 This Example illustrates the accounting under the Demutualizations Subsections of this Subtopic for closed block business (meaning those assets and liabilities both inside and outside of the closed block that relate to or support the closed block policies) after the demutualization date. This Example illustrates the computations involved in the following:

a. Determining the amount of the policyholder dividend obligation
b. Subparagraph superseded by Accounting Standards Update No. 2018-12.
c. Subparagraph superseded by Accounting Standards Update No. 2018-12.

55-7 For simplicity, this Example assumes the closed block has not been funded for income taxes. In practice, the closed block may or may not be funded for income taxes. If the closed block is funded for income taxes, the actuarial calculation would be constructed on a post-tax basis. However, for the purpose of determining the policyholder dividend obligation, pretax amounts should be used. Generally, this would be accomplished by converting post-tax actuarial calculation values to corresponding pretax values for purposes of determining the policyholder dividend obligation. If the closed block is funded for income taxes, a change in income tax rates would result in an experience gain or loss that would affect closed block cash flows.

55-8 The closed block business is assumed to be written in Year 1, with demutualization occurring at the end of Year 5. Present values are assumed at a discount rate of 8.5 percent.

55-9 As discussed beginning in paragraph 944-805-25-10, the table in paragraph 944-805-55-10 is based on the actuarial calculation for the closed block developed at the demutualization date and represents the expected changes in the **net closed block liability** (closed block deficit) over the life of the closed block. The data in that table would be compared to actual results throughout the life of the closed block to determine the need for a policyholder dividend obligation. That table assumes an increase in interest rates in Year 6 from 8.5 percent to 9.5 percent, which results in the board of directors increasing dividends in Years 7 through 10. The table assumes demutualization begins in Year 6. For purposes of the Example, all other assumptions are held constant and expenses are assumed to be excluded from the closed block.

55-10 Components of the illustrative closed block follow.

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Year	Premium	Interest on Closed Block Assets	Interest on Current Activity	Death Benefits Incurred	Surrender Benefits Incurred	(Increase) Decrease in Net Level Premium Reserve	Dividend Incurred	(Increase) Decrease in Policyholder Dividend Obligation
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
1	$ 210,000	$ -	$ 17,850	$ (9,000)	$ -	$ (126,103)	$ (18,857)	$ -
2	184,611	7,231	15,692	(10,549)	-	(109,116)	(21,399)	-
3	169,621	7,846	14,418	(13,731)	(7,148)	(93,669)	(24,230)	-
4	155,763	8,512	13,240	(14,835)	(14,984)	(79,754)	(26,574)	-
5	142,990	9,236	12,154	(15,661)	(21,760)	(67,117)	(28,509)	-
6	131,222	11,200	12,466	(15,622)	(17,237)	(73,236)	(30,043)	(2,491)
7	124,333	17,839	10,568	(16,578)	(20,989)	(66,499)	(33,061)	549
8	117,768	24,819	10,010	(16,824)	(24,427)	(60,005)	(35,127)	595
9	111,526	31,298	9,480	(17,526)	(27,566)	(53,706)	(36,990)	646
10	105,582	37,266	8,974	(18,603)	(30,406)	(47,485)	(38,675)	701
11–20	779,517	585,648	66,259	(311,112)	(398,831)	(162,077)	(424,092)	-
21–55	589,392	1,103,633	50,099	(1,187,632)	(686,079)	938,767	(669,668)	-
Total	$ 2,822,325	$ 1,844,528	$ 241,210	$ (1,647,673)	$ (1,249,427)	$ -	$ (1,387,225)	$ -

Notes:
(a) Gross premiums.
(b) Interest at 8.5 percent on the liability for future policy benefits at the end of the previous year.
(c) Interest at 8.5 percent on current-year cash flow. This illustration assumes that premiums are received and all expenses are incurred at the start of the year. This illustration assumes that death benefits, surrender benefits, and dividends are all at the end of the year.
(d) Death benefits not reduced by related liability for future policy benefits.
(e) Surrender benefits not reduced by related liability for future policy benefits.
(f) Represents the cumulative (increase) decrease in the liability for future policy benefits.
(g) Policyholder dividends for the year.
(h) Policyholder dividend obligation as of end of last year minus policyholder dividend obligation as of end of current year.

55-11 For purposes of the table in paragraph 944-805-55-10, the product of the closed block policyholder dividend obligation calculation follows.

Actual as of Measurement Date	$ 18,750
– Initial Actuarial Calculation	$ 16,259
= Policyholder Dividend Obligation at Measurement Date	$ 2,491

This section addresses disclosure requirements for balances amortized consistent with DAC, premium deficiency testing and other miscellaneous disclosure items.

Question 6.6.10 Do the tabular disclosures for DAC also apply to deferred sales inducements?

Interpretive response: Yes. An entity applies all of the disclosure requirements for DAC to deferred sales inducements. This includes (dis)aggregation in a manner that is consistent with the (dis)aggregation of the related liability disclosure. [944-30-50-2A]

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Question 6.6.20 What disclosures apply for balances an entity elects to amortize on a basis consistent with DAC?

Interpretive response: If an entity elects to amortize balances on a basis consistent with DAC, it follows the DAC disclosure requirements for annual and interim reporting periods, including a: [944-30-50-2B]

- year-to-date disaggregated tabular rollforward of the beginning to the ending balance of the unamortized balance; and
- reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount in the balance sheet.

Although not specifically required for balances amortized on a basis consistent with DAC, we believe an entity should consider disclosing information required by paragraph 944-30-50-2A for balances amortized on a basis consistent with DAC, including: [944-30-50-2A]

- the nature of the amounts;
- inputs, judgments, assumptions and methods used to determine amortization amounts; and
- changes in those inputs, judgments and assumptions.

For additional guidance on balances amortized on a basis consistent with DAC, see section 5.2. [944-30-50-2B(a)]

Question 6.6.30 Does an entity need to disclose fair value information on MRBs separately under Topic 820?

Interpretive response: Generally, no. If an entity's tabular rollforward of the beginning to the ending balance related to MRBs (measured at fair value – see Question 3.4.10) also satisfies the fair value disclosure requirements described in Section 820-10-50 of the fair value measurement standard, the entity does not need to duplicate the disclosure. However, if the fair value disclosure requirements are not satisfied, the entity makes additional fair value disclosures either within the MRB disclosure or the fair value disclosure. [944-40-55-13K, 820-10-50]

For example, paragraph 820-10-50-2(c) requires a reconciliation from the opening balance to the closing balance for Level 3 fair value measurements. If the information in the MRB rollforward satisfies these disclosure requirements, the entity does not need to disclose a Level 3 rollforward in addition to the MRB rollforward. [944-40-55-13K]

Question 6.6.40 In what order are cash flow assumption changes run through the actuarial model to quantify the effect of assumption changes?

Interpretive response: ASU 2018-12 does not specify how an entity should calculate the effect of cash flow assumption changes. We believe an entity

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should establish a policy for the order in which it changes cash flow assumptions in the model, which should be applied consistently. [944-40-50-7(b)]

Question 6.6.50 What does an entity disclose when it performs a premium deficiency test?

Interpretive response: When an entity performs a premium deficiency test, whether or not a liability for a premium deficiency is established, it discloses: [944-60-50-2(b) – 50-2(c)]

- information about its premium deficiency testing methodology; and
- whether it includes an assumption for anticipated investment income.

If an entity includes an assumption for anticipated investment income, that assumption is disclosed. [944-60-50-2(c)]

When a liability for a premium deficiency is established, the liability and a description of the factors that led to establishment of the liability are disclosed. [944-60-50-2(a)]

For a discussion about the types of contracts subject to premium deficiency testing, see Question 2.5.20.

Question 6.6.60 Are disclosures required for premium deficiency testing of closed blocks?

Interpretive response: Yes. An entity with closed blocks must disclose the results of premium sufficiency or deficiency of the closed block. [944-805-50-3(a)(4)]

For guidance on premium deficiency disclosures, see Question 6.6.50.

Question 6.6.70 If an entity separately presents the unpaid claims liability, how is the discount rate change presented in the liability for unpaid claims rollforward?

Interpretive response: Under ASU 2018-12, an entity calculates a single liability for future policy benefits that comprises all expected cash flows under the contract, including those for claims incurred. An entity may elect to separately present the components of the single liability similar to legacy US GAAP – e.g. separately present a liability for unpaid claim and claim adjustment expenses for incurred claims not yet paid.

In this situation, we believe an entity should disclose the effect of changes in discount rate assumptions in the liability for unpaid claims rollforward as a separate line item. This presentation is similar to the presentation of the changes in discount rate assumptions in the liability for future policy benefits rollforward. [944-40-50-3, 55-29E]

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For guidance on the cash flows included in the liability for future policy benefits calculation, see Question 2.3.85. For guidance on presentation, see Question 2.7.20.

Question 6.6.80 What period is used for quantitative disclosures?

Interpretive response: ASU 2018-12 requires new and expanded disclosures for annual and interim reporting periods. When evaluating the requirements, an entity considers whether the disclosures relate to the balance sheet or income statement. If a quantitative disclosure relates to the: [944-40-50, 944-40-55]

- balance sheet, then it should be provided as of the date of each balance sheet presented.
- income statement, then it should be provided for each reporting period for which an income statement is presented.

For example, the weighted-average interest rate required for the liability for future policy benefits for traditional and limited-payment contracts and the additional liability for annuitization, death or other insurance benefits is provided as of the date of each balance sheet presented. [944-40-50-6(b)(6)]

In contrast, the interest rate used to present the discounted ending balance of expected future gross premiums is the income statement accretion rate. It is provided for each income statement presented. [944-40-50-6(b)(1)]

Question 6.6.90 Does the interest expense disclosed agree to the income statement?

Interpretive response: Maybe. Under ASU 2018-12, an entity discloses the amount of interest recorded in the income statement related to the liability for future policy benefits. [944-40-50-6(b)(3)]

Rather than presenting this interest expense as a separate line item in the income statement, an entity may aggregate it with interest expense related to items other than the liability for future policy benefits and present it in a single line item. Therefore, the disclosure of interest expense related to the liability for future policy benefits may not reconcile directly to interest expense presented in the income statement. However, we believe an entity should disclose where interest expense is presented in the income statement.

Question 6.6.100 How are the changes in the net premium ratio for a group of contracts disclosed when it remains greater than 100%?

Interpretive response: For traditional and limited-payment contracts, an entity is required to disclose qualitative and quantitative information about adverse development that resulted in an immediate charge to current-period net income

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because of net premiums exceeding gross premiums – i.e. the net premium ratio is greater than 100%. The net premium ratio used to calculate the liability for future policy benefits for a group of contracts is updated for actual experience at least annually. [944-40-35-5(a)(1), 50-6(d)]

In a reporting period after an entity records an immediate charge to net income because the net premium ratio is greater than 100%, if the updated net premium ratio: [944-40-50-6(d)]

- decreased but remains greater than 100%, there are no required disclosures because there was no adverse development. However, we believe an entity considers whether disclosure of qualitative and/or quantitative information about the group of contracts and their favorable development provides decision-useful information to the users of the financial statements;
- increased, the entity records an immediate charge to net income for the incremental adverse development in the current reporting period and discloses qualitative and quantitative information about the adverse development.

For additional discussion about the accounting when the net premium ratio is greater than 100%, see Questions 2.3.130 and 2.3.190.

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7. Effective dates and transition

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7.1 How the standard works

Effective dates	SEC filers, except smaller reporting companies[1,2]	Other entities
Annual periods – Fiscal years beginning after:	Dec. 15, 2022	Dec. 15, 2024
Interim periods – In fiscal years beginning after:	Dec. 15, 2022	Dec. 15, 2025
Early adoption allowed?	Yes. If early adoption is elected, the transition date is either the beginning of the prior period presented or the beginning of the earliest period presented.	
Transition method		
Liability for future policy benefits[3]	Modified retrospective method (carryover basis transition) applied to contracts in force at the transition date. May elect to apply retrospectively, if certain criteria are met.	
Market risk benefits	Retrospective at the transition date.	
Deferred acquisition costs[3]	Modified retrospective method (carryover basis transition) applied to contracts in force at the transition date. May elect to apply retrospectively, if certain criteria are met.	
Exclusions		
Contracts derecognized before the effective date because of sale or disposal	Accounting policy election to exclude certain contracts from applying the amendments in ASU 2018-12 when the contracts have been derecognized before the effective date and the entity has no significant continuing involvement. May apply on a transaction-by-transaction basis to all contracts in a sale or disposal transaction, if certain criteria are met.	

Notes:

1. An SEC filer is an entity that is required to file or furnish its financial statements with either (1) the SEC or (2) with respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section. Financial statements for other entities that are not otherwise SEC filers whose financial statements are included with another filer's SEC submission are not included in this definition. [Master Glossary]
2. An entity's determination about whether it is eligible to be a 'smaller reporting company' is based on its most recent filing determination in accordance with SEC regulations as of November 15, 2019. [944-40-65-2(a)]
3. The transition method used for the liability for future policy benefits and DAC should be the same. [944-40-65-2(c), 65-2(e)(1)]

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7.2 Effective dates and exclusions

Excerpt from ASC 944-40

> Transition Related to Accounting Standards Updates No. 2018-12, *Financial Services–Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, No. 2019-09, *Financial Services–Insurance (Topic 944): Effective Date*, and No. 2020-11, *Financial Services-Insurance (Topic 944): Effective Date and Early Application*

65-2 The following represents the transition and effective date information related to Accounting Standards Updates No. 2018-12, *Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts,* No. 2019-09*, Financial Services—Insurance (Topic 944): Effective Date,* and No. 2020-11*, Financial Services—Insurance (Topic 944): Effective Date and Early Application*, and No. 2022-05, *Financial Services – Insurance (Topic 944): Transition for Sold Contracts*:

a. For **public business entities** that meet the definition of a **Securities and Exchange Commission (SEC) filer**, excluding entities eligible to be smaller reporting companies as defined by the SEC, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. The one-time determination of whether an entity is eligible to be a smaller reporting company shall be based on an entity's most recent determination as of November 15, 2019, in accordance with SEC regulations. Early application is permitted. If early application is elected, the transition date shall be either the beginning of the prior period presented or the beginning of the earliest period presented. If early application is not elected, the transition date shall be the beginning of the earliest period presented.
b. For all other entities, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. Early application is permitted. If early application is elected, the transition date shall be either the beginning of the prior period presented or the beginning of the earliest period presented. If early application is not elected, the transition date shall be the beginning of the earliest period presented.

Contracts derecognized before the effective date because of sale or disposal

q. An insurance entity may make an accounting policy election to exclude from the pending content that links to this paragraph certain contracts that meet all the following as of the effective date:
    1. The contracts have been derecognized because of a sale or disposal. The sale or disposal may be on an individual contract basis, on a group basis, or on a legal entity basis.
    2. The insurance entity has no significant continuing involvement with the derecognized contracts.

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r. The following are forms of significant continuing involvement that would not meet the criteria in (q)(2) and would prohibit an insurance entity from applying the accounting policy election:
    1. An interest that provides significant influence over the derecognized contracts. To determine whether significant influence exists, an insurance entity shall consider the guidance in paragraphs 323-10-15-6 through 15-11, including for equity ownership interests that are not within the scope of that guidance.
    2. Any other arrangement that allows for significant participation in the derecognized contract.
s. The following are examples that would not be considered significant continuing involvement as described in (q)(2) and therefore would allow an insurance entity to apply the accounting policy election:
    1. Investment management, policy servicing, or other administrative arrangements.
    2. Standard merger and acquisition representation and warranties.
t. An insurance entity shall apply the accounting policy election to all contracts within a sale or disposal transaction that meet the criteria in (q). The accounting policy election shall be applied at the sale or disposal transaction level.

Excerpt from ASC 323-10

> Other Considerations

• > Significant Influence

15-6 Ability to exercise significant influence over operating and financial policies of an investee may be indicated in several ways, including the following:

a. Representation on the board of directors
b. Participation in policy-making processes
c. Material intra-entity transactions
d. Interchange of managerial personnel
e. Technological dependency
f. Extent of ownership by an investor in relation to the concentration of other shareholdings (but substantial or majority ownership of the voting stock of an investee by another investor does not necessarily preclude the ability to exercise significant influence by the investor).

15-7 Determining the ability of an investor to exercise significant influence is not always clear and applying judgment is necessary to assess the status of each investment.

15-8 An investment (direct or indirect) of 20 percent or more of the voting stock of an investee shall lead to a presumption that in the absence of predominant evidence to the contrary an investor has the ability to exercise significant influence over an investee. Conversely, an investment of less than 20 percent of the voting stock of an investee shall lead to a presumption that an investor does not have the ability to exercise significant influence unless such ability can be demonstrated. The equity method shall not be applied to the investments described in this paragraph insofar as the limitations on the

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use of the equity method outlined in paragraph 323-10-25-2 would apply to investments other than those in **subsidiaries**.

15-9 An investor's voting stock interest in an investee shall be based on those currently outstanding securities whose holders have present voting privileges. Potential voting privileges that may become available to holders of securities of an investee shall be disregarded.

15-10 Evidence that an investor owning 20 percent or more of the voting stock of an investee may be unable to exercise significant influence over the investee's operating and financial policies requires an evaluation of all the facts and circumstances relating to the investment. The presumption that the investor has the ability to exercise significant influence over the investee's operating and financial policies stands until overcome by predominant evidence to the contrary. Indicators that an investor may be unable to exercise significant influence over the operating and financial policies of an investee include the following:

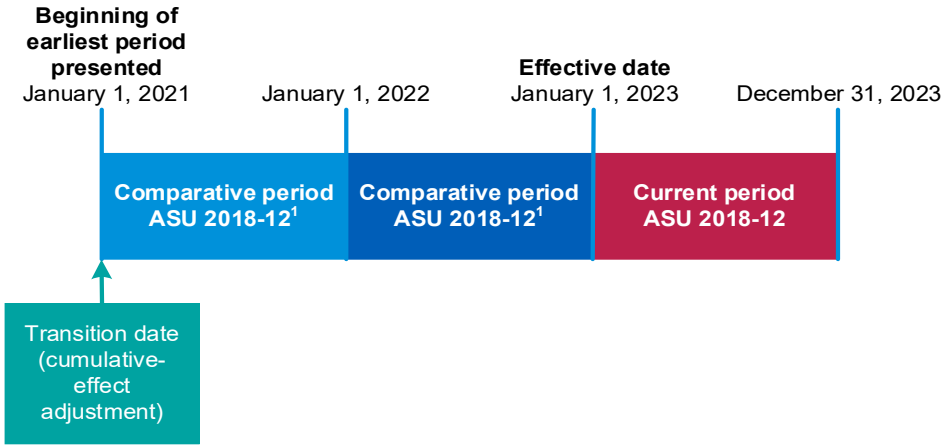
a. Opposition by the investee, such as litigation or complaints to governmental regulatory authorities, challenges the investor's ability to exercise significant influence.
b. The investor and investee sign an agreement (such as a **standstill agreement**) under which the investor surrenders significant rights as a shareholder. (Under a standstill agreement, the investor usually agrees not to increase its current holdings. Those agreements are commonly used to compromise disputes if an investee is fighting against a takeover attempt or an increase in an investor's percentage ownership. Depending on their provisions, the agreements may modify an investor's rights or may increase certain rights and restrict others compared with the situation of an investor without such an agreement.)
c. Majority ownership of the investee is concentrated among a small group of shareholders who operate the investee without regard to the views of the investor.
d. The investor needs or wants more financial information to apply the equity method than is available to the investee's other shareholders (for example, the investor wants quarterly financial information from an investee that publicly reports only annually), tries to obtain that information, and fails.
e. The investor tries and fails to obtain representation on the investee's board of directors.

15-11 The list in the preceding paragraph is illustrative and is not all-inclusive. None of the individual circumstances is necessarily conclusive that the investor is unable to exercise significant influence over the investee's operating and financial policies. However, if any of these or similar circumstances exists, an investor with ownership of 20 percent or more shall evaluate all facts and circumstances relating to the investment to reach a judgment about whether the presumption that the investor has the ability to exercise significant influence over the investee's operating and financial policies is overcome. It may be necessary to evaluate the facts and circumstances for a period of time before reaching a judgment.

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7.2.10 Overview

If a calendar year-end SEC filer that is not eligible to be an SRC adopts ASU 2018-12 at the mandatory effective date, the following are the relevant dates. [944-40-65-2]



Note:

1. Previously reported under legacy US GAAP.

Question 7.2.10 If adopted early, do all provisions of ASU 2018-12 have to be adopted at the same time?

Interpretive response: Yes. If an entity elects to apply ASU 2018-12 before the mandatory effective date, all provisions of the ASU have to be adopted at the same time. [944-40-65-2]

Question 7.2.20 Can an entity early adopt at an interim date?

Interpretive response: No. We believe an entity is permitted to early adopt ASU 2018-12 only as of the beginning of a fiscal year. This is because the early adoption language in the ASU specifically references the beginning of the prior period presented or the beginning of the earliest period presented. For example, we believe a calendar year-end entity can early adopt ASU 2018-12 as of January 1 but not as of an interim date (such as April 1). [944-40-65-2(a) – 65-2(b)]

If early adoption of ASU 2018-12 is elected, the transition date is the beginning of the prior period presented or the beginning of the earliest period presented.

Observation Subsidiaries of registrants

For calendar year-end SEC filers that are not SRCs, the mandatory effective date is January 1, 2023. For these filers, the transition date is January 1, 2021.

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Subsidiaries of SEC filers may decide to early adopt to align their stand-alone financial statement transition date to that of their SEC filer parent. If early adoption is elected, the non-SEC subsidiaries will need to present certain financial statements from their transition date to their early adoption effective date.

7.2.20 Exclusions

An entity may make an accounting policy election to exclude certain contracts that meet both of the following 'derecognition criteria' as of the effective date. [944-40-65-2(q)]

- The contracts have been derecognized because of a sale or disposal. The sale or disposal may be on an individual contract basis, on a group basis, or on a legal entity basis.
- The entity has no significant continuing involvement with the derecognized contracts.

Significant continuing involvement examples	
Significant continuing Involvement	• An interest that provides significant influence over the derecognized contracts, as described in paragraphs 323-10-15-6 to 15-11 [944-40-65-2(r)(a)] • Any other arrangement that allows for significant participation in the ongoing performance of the derecognized contract [944-40-65-2(r)(b)]
Not considered significant continuing involvement	• Investment management, policy servicing or other administrative arrangements [944-40-65-2(s)(a)] • Standard merger and acquisition representations and warranties [944-40-65-2(s)(b)]

This accounting policy election can be applied on a transaction-by-transaction basis. An entity discloses a qualitative description of the sale or disposal transaction(s) to which it applied the accounting policy election. [944-40-65-2(t) – 65-2(u)]

The FASB believes this exclusion reduces the cost and complexity of applying ASU 2018-12 because the election is applied at the transaction level and the derecognized contracts have no future cash flows. [ASU 2022-05.BC7 – BC10]

Question 7.2.30 If elected, must the accounting policy election be applied to all contracts in a sale or disposal transaction?

Interpretive response: Yes. The accounting policy election to exclude certain derecognized contracts must be applied to all contracts in a sale or disposal transaction that meets the derecognition criteria. While the accounting policy election can be applied on a transaction-by-transaction basis, an entity is not

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allowed to disaggregate the contracts in a sale or disposal transaction when applying the accounting policy election. [944-40-65-2(t)]

Question 7.2.40 Can an entity apply the accounting policy election to reinsurance terminations or recaptures?

Interpretive response: No. Only contracts that have been derecognized because of a sale or disposal are eligible for the accounting policy election. Because reinsurance recaptures and early contract terminations are not sales or disposals, they do not meet the derecognition criteria to apply the accounting policy election. Therefore, an assuming entity is not allowed to apply the accounting policy election to reinsurance terminations or recaptures by the ceding entity. [ASU 2022-05.BC13]

Question 7.2.50 Can an entity apply the accounting policy election to contracts in a ceded reinsurance contract?

Interpretive response: No. Only contracts that have been derecognized because of a sale or disposal are subject to the accounting policy election. Because the ceding entity remains liable to the insured for the payment of policy benefits, it continues to account for and report the underlying insurance contracts. As such, those contracts do not meet the derecognition criteria required to make the accounting policy election. [944-20 Glossary, ASU 2022-05.BC13]

However, if the entity has entered into an assumption or novation reinsurance contract that legally replaces the entity and its liability to the policyholder has been extinguished, then the entity may be able to apply the accounting policy election after evaluating both components of the derecognition criteria. [944-20 Glossary, ASU 2022-05.BC13]

7.3 Transition – liability for future policy benefits and DAC

7.3.10 Overview

Excerpt from ASC 944-40

> Transition Related to Accounting Standards Updates No. 2018-12, *Financial Services–Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, No. 2019-09, *Financial Services–Insurance (Topic 944): Effective Date*, and No. 2020-11, *Financial Services-Insurance (Topic 944): Effective Date and Early Application*

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65-2 The following represents the transition and effective date information related to Accounting Standards Updates No. 2018-12, *Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts,* No. 2019-09*, Financial Services—Insurance (Topic 944): Effective Date,* and No. 2020-11*, Financial Services—Insurance (Topic 944): Effective Date and Early Application*: …

Liability for future policy benefits and deferred acquisition costs

c. At the transition date, an insurance entity shall apply the pending content that links to this paragraph about the **liability for future policy benefits** and deferred **acquisition costs** (and balances amortized on a basis consistent with deferred acquisition costs, either as required by this Topic or as a result of an accounting policy election) to contracts **in force** on the basis of their existing carrying amounts at the transition date and by using updated cash flow assumptions, adjusted for the removal of any amounts in accumulated other comprehensive income.

d. For the liability for future policy benefits:
   1. For purposes of determining the ratio of **net premiums** to **gross premiums** and for purposes of interest accretion, an insurance entity shall retain the discount rate assumption that was used to calculate the liability immediately before the application of the pending content that links to this paragraph.
   2. The present value of future benefits and related expenses less the transition date carrying amount shall be compared with the present value of future gross premiums to calculate the ratio of net premiums to gross premiums.
   3. An insurance entity shall adjust the opening balance of retained earnings only to the extent that net premiums exceed gross premiums.
   4. An insurance entity shall compare the liability for the future policy benefits balance using the discount rate assumption in (d)(1) and the current discount rate (that is, the upper-medium-grade [low-credit-risk] fixed-income instrument yield as of the transition date). Any resulting difference in the liability for the future policy benefits balance shall be recorded to opening accumulated other comprehensive income.
   5. The transition date shall be considered the revised contract issue date for purposes of subsequent adjustments but not for purposes of contract grouping.
   6. For contracts in force issued before the transition date, an insurance entity shall not group contracts together from different original contract issue years but shall group contracts into quarterly or annual groups on the basis of original contract issue date for purposes of calculating the liability for future policy benefits. For acquired contracts, the acquisition date shall be considered the original contract issue date.

e. An insurance entity may elect to apply the pending content that links to this paragraph retrospectively (with a cumulative catch-up adjustment to the opening balance of retained earnings or the opening balance of accumulated other comprehensive income, as applicable, as of the transition date) using actual historical experience information as of contract inception (or contract acquisition, if applicable). For consistency:
   1. An insurance entity shall apply the same transition method to both the liability for future benefits and deferred acquisition costs (and balances

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amortized on a basis consistent with deferred acquisition costs, either as required by this Topic or as a result of an accounting policy election).
2. The retrospective election shall be made at the same contract issue-year level for both the liability for future policy benefits and deferred acquisition costs for that contract issue year and all subsequent contract issue years, on an entity-wide basis (that is, applied to all contracts and product types).
3. Estimates of historical experience information shall not be substituted for actual historical experience information.
4. An insurance entity shall apply the pending content that links to this paragraph in accordance with (c) and (d) for contracts issued (or acquired) before the earliest issue-year level elected for retrospective application.

7.3.20 Transition method election

Excerpts from ASC 944-40

> Transition Related to Accounting Standards Updates No. 2018-12, *Financial Services–Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, No. 2019-09, *Financial Services–Insurance (Topic 944): Effective Date*, and No. 2020-11, *Financial Services-Insurance (Topic 944): Effective Date and Early Application*

65-2 The following represents the transition and effective date information related to Accounting Standards Updates No. 2018-12, *Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts,* No. 2019-09*, Financial Services—Insurance (Topic 944): Effective Date,* and No. 2020-11*, Financial Services—Insurance (Topic 944): Effective Date and Early Application: …*

Implementation guidance: retrospective transition

i. As stated in (e), at the transition date an insurance entity has the option to apply the guidance on the liability for future policy benefits for traditional and limited-payment contracts on a retrospective basis at the issue-date contract aggregation level to all contract groups for that issue date and all subsequent issue dates. An insurance entity applying the retrospective approach at the transition date shall:
   1. Recalculate the net premiums as of the contract issue date by considering the actual historical experience and updated future cash flow assumptions, discounted using a rate based on an upper-medium-grade (low-credit-risk) fixed-income instrument yield at the contract issue date. That newly determined discount rate represents the interest accretion rate to be used over the life of the contract.
   2. Use the revised net premiums to measure the liability for future policy benefits as of the transition date.
   3. Record a cumulative catch-up adjustment to the opening balance of retained earnings as of the transition date equal to the difference between the carrying value of the liability for future policy benefits

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(adjusted for the removal of any related amounts in accumulated other comprehensive income) and the liability for the future policy benefits balance calculated using the updated net premiums.

j. Additionally, at the transition date, an insurance entity shall compare the liability for the future policy benefits balance using the interest accretion rate and the current discount rate (that is, the upper-medium-grade [low-credit-risk] fixed-income instrument yield as of the transition date). Any resulting difference in the liability for the future policy benefits balance shall be recorded to accumulated other comprehensive income.

Implementation guidance: carryover basis transition

k. An insurance entity may have implemented the transition guidance in (c) to all or some contracts in force on the basis of their carrying amounts (adjusted for the removal of any related amounts in accumulated other comprehensive income) at the transition date (that is, the carryover basis) and updated future assumptions. The transition date shall be considered the revised contract issue date for purposes of subsequent adjustments but not for purposes of contract grouping: the original contract issue date shall be used for purposes of contract grouping, and contracts from different original contract issue years shall not be grouped.

l. At the transition date, an insurance entity shall update future cash flow assumptions and calculate net premiums using the ratio of the present value of remaining expected benefits and expense amounts, less the carryover basis to the present value of expected remaining gross premiums (see Example 7 beginning in paragraph 944-40-55-29P).

m. In determining the ratio of net premiums to gross premiums at the revised contract issue date, an insurance entity shall apply the discount rate assumption that was used to calculate the existing liability for future policy benefits (that is, the discount rate in effect immediately before the transition date shall be retained and used in subsequent reporting periods for the purpose of determining the ratio of net premiums to gross premiums and for the purpose of interest accretion). Additionally, at the transition date, an insurance entity shall compare the liability for the future policy benefits balance using the interest accretion rate and the current discount rate (that is, the upper-medium-grade [low-credit-risk] fixed-income instrument yield as of the transition date). Any resulting difference in the liability for the future policy benefits balance shall be recorded to accumulated other comprehensive income.

n. If the transition date adjustment related to updating cash flow assumptions is unfavorable because the expected net premiums exceed the expected gross premiums (that is, the present value of remaining expected benefits and expenses less the carryover basis exceeds the present value of expected gross premiums), an insurance entity shall:
    1. Adjust the liability for future policy benefits at the transition date for the removal of any related amounts in accumulated other comprehensive income
    2. Set net premiums equal to gross premiums
    3. Increase the liability for future policy benefits and, for **limited-payment contracts**, reduce the deferred profit liability balance to zero
    4. Recognize a corresponding adjustment to the opening balance of retained earnings as of the transition date

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5. Disclose information related to the adverse development that results in net premiums exceeding gross premiums (see paragraph 944-40-50-6(d)).

o. If the transition date adjustment related to updating cash flow assumptions is unfavorable but does not result in net premiums exceeding gross premiums, an insurance entity shall:
   1. Adjust the liability for future policy benefits at the transition date for the removal of any related amounts in accumulated other comprehensive income
   2. Not increase the liability for future policy benefits, except for limited-payment contracts, in which case any reduction to the deferred profit liability shall be offset with a corresponding increase in the liability for future policy benefits
   3. Not recognize an adjustment to the opening balance of retained earnings as of the transition date
   4. Apply the newly determined ratio of net premiums to gross premiums as of the transition date, until assumptions are subsequently updated.

p. If the transition date adjustment related to updating cash flow assumptions is favorable, an insurance entity shall:
   1. Adjust the liability for future policy benefits at the transition date for the removal of any related amounts in accumulated other comprehensive income
   2. Not decrease the liability for future policy benefits, except for limited-payment contracts, in which case any increase in the deferred profit liability shall be offset with a corresponding decrease in the liability for future policy benefits
   3. Not recognize an adjustment to the opening balance of retained earnings as of the transition date
   4. Apply the newly determined ratio of net premiums to gross premiums as of the transition date.

7.3.30 Liability for future policy benefits

An entity applies ASU 2018-12 using a modified retrospective method (carryover basis transition method) to existing contracts on the transition date – unless the criteria to apply retrospectively are met and the retrospective method is elected. [944-40-65-2(d) – 65-2(e)]

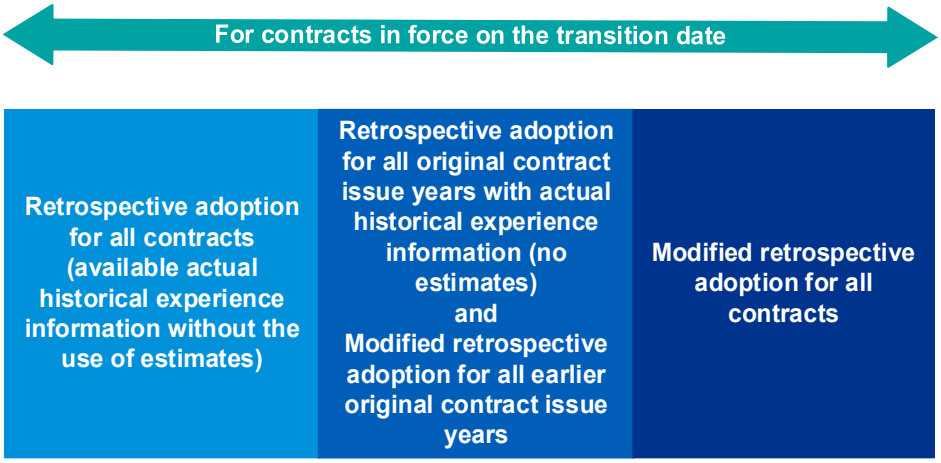
If ASU 2018-12 is applied retrospectively with a cumulative-effect adjustment to opening retained earnings, an entity is required to use the: [944-40-65-2(e)]

- same contract issue-year level on an entity-wide basis for that issue year and all subsequent issue years for all product lines; and
- actual historical experience information as of contract issuance.

ASU 2018-12 prohibits using estimates of historical experience information as a substitute for actual information. The availability of historical experience information may limit when retrospective adoption can be used. [944-40-65-2(e)]

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The following diagram illustrates the transition methods in ASU 2018-12.

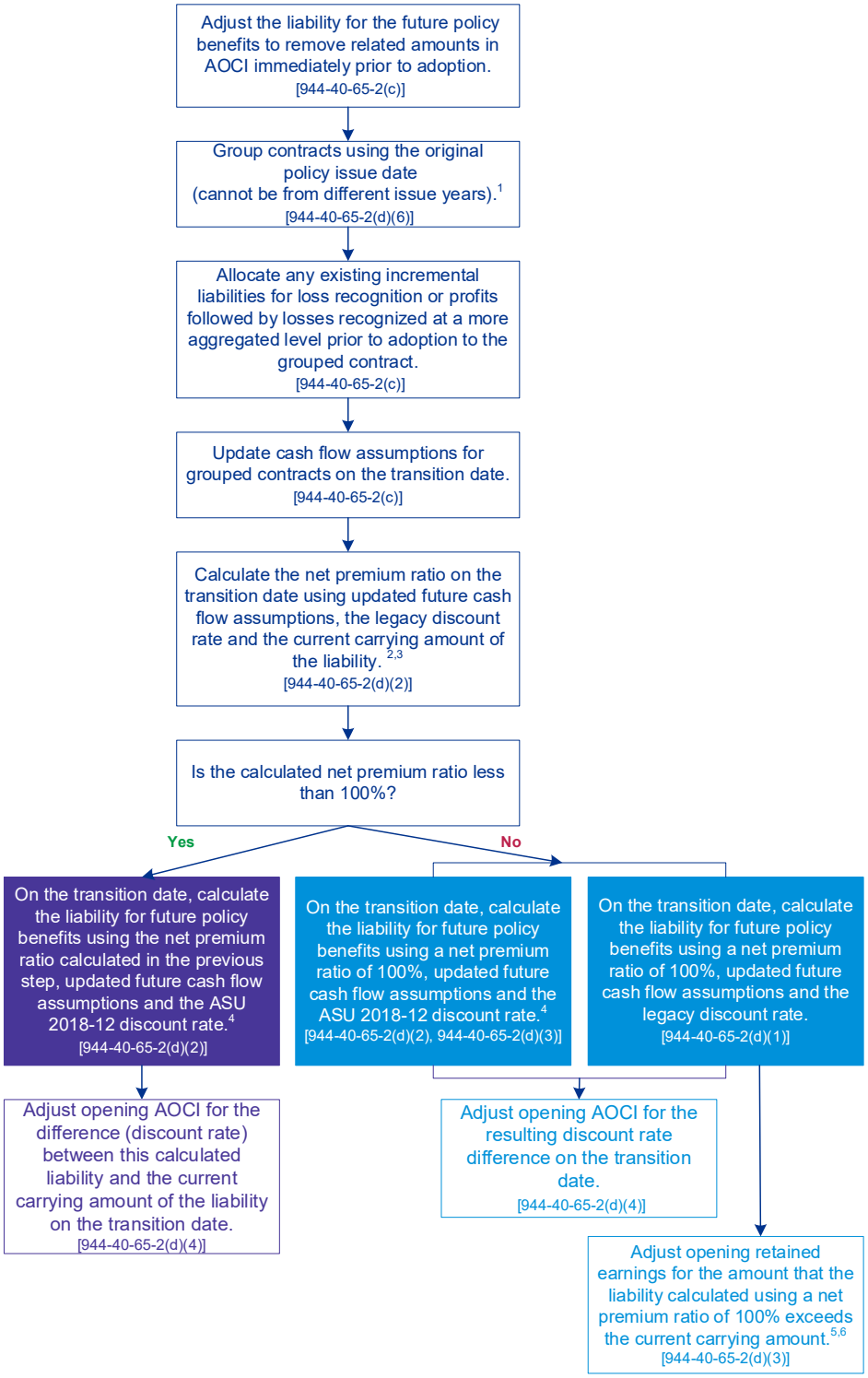


Under the modified retrospective method, on the transition date, an entity calculates the ratio of net premiums to gross premiums (net premium ratio) using updated cash flow assumptions and the discount rate immediately before the transition date (Legacy Discount Rate). Any difference between this calculated net premium ratio and the net premium ratio used to calculate the pre-transition carrying amount of the liability (which includes the DPL) is prospectively recognized in future periods. Then, the entity uses this ratio to calculate the liability for future policy benefits using two different discount rates. The first is the Legacy Discount Rate. The second is the new ASU 2018-12 discount rate. The difference in the liability for future policy benefits using the two different discount rates is recorded in AOCI at transition. [944-40-65-2(d), 65-2(l) – 65-2(m)]

Contracts entered into after the transition date do not affect the cumulative-effect adjustment that is recognized, but are recognized using the guidance in ASU 2018-12 at the contract issue date.

The following flowchart highlights the steps to calculate transition related adjustments for the liability for future policy benefits using the modified retrospective method. For limited-payment contract considerations, see Question 7.3.90. [944-40-65-2(c) – 65-2(d), 65-2(k) – 65-2(p)]

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Notes:

1. Grouping should be consistent with the discussion in chapter 2. The original contract issue date should be used to group contracts into contract groups. Groups should not include contracts from different original issue years. For acquired contracts, the

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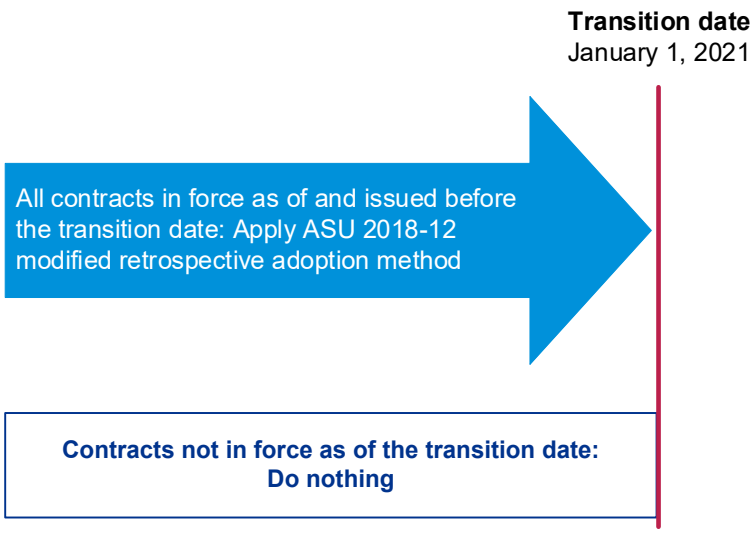
acquisition date should be considered the original contract issue date. [944-40-65-2(d)(6)]

2. The discount rate assumption used immediately before adoption (legacy discount rate) is also used to calculate interest accretion in future periods. [944-40-65-2(d)(1)]
3. Calculated using the legacy discount rate and updated future cash flow assumptions from the transition date forward: [(Present value of future benefits and expenses – current carrying amount of the liability on the transition date after adjustment for removal of amounts in AOCI and allocation of incremental liabilities) ÷ (Present value of future gross premiums)]. [944-40-65-2(d)(2)]
4. The discount rate at transition is the upper-medium-grade (low-credit-risk) fixed-income instrument yield. [944-40-65-2(d)(4)]
5. Difference between the current carrying amount of the liability less the liability calculated because net premiums exceeded gross premiums (using a net premium ratio of 100%, future cash flow assumptions and the legacy discount rate). [944-40-65-2(d)(3)]
6. For limited-payment contract considerations, see Question 7.3.90.

Question 7.3.10 What is the required transition method for liabilities for future policy benefits?

Interpretive response: ASU 2018-12 requires a modified retrospective adoption method unless the criteria to retrospectively adopt are met *and* the retrospective method is elected. Under the modified retrospective method, an entity applies the guidance to all in-scope contracts in force on the transition date using updated future cash flow assumptions and eliminates any related amounts in AOCI. [944-40-65-2(c)]

The diagram depicts the timing of the *modified retrospective* transition model.

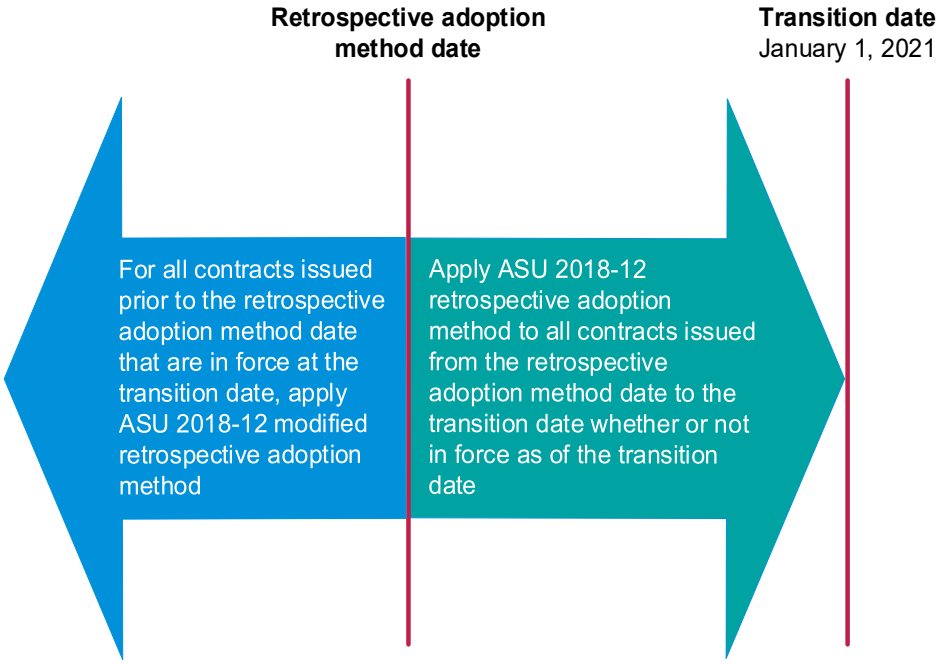


An entity that elects to use the retrospective method and meets the related criteria applies the guidance to all in-scope contracts in force during the retrospective adoption period. To use the retrospective adoption method, an entity is required to use actual historical experience on an entity-wide basis (all

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contracts and all product lines) for that issue year and all subsequent issue years. No estimates are allowed. For the earliest year elected for the retrospective adoption date, the entity uses actual historical experience information for all of its in-scope contracts in force for that issue year and all subsequent issue years. [944-40-65-2(e)]

The diagram depicts the timing of the *retrospective* transition model.



Question 7.3.20 What date is used to determine the cumulative-effect adjustment when using a modified retrospective method of transition?

Interpretive response: ASU 2018-12 requires a modified retrospective adoption method applied to all in-scope contracts in force on the transition date. The transition date is defined as the beginning of the earliest period presented. If early adoption is elected, the transition date is either the beginning of the prior period presented or the beginning of the earliest period presented. The cumulative-effect adjustment is recognized on the transition date (see section 7.2.10). [944-40-65-2(c)]

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Question 7.3.30 Can estimates of historical information be used if the retrospective method of adoption is elected?

Interpretive response: No. ASU 2018-12 precludes using estimates if the retrospective method of adoption is elected. Actual historical experience information is required on an entity-wide basis (all contracts and product lines) for that issue year and all subsequent issue years. For further discussion, see Question 7.3.10. [944-40-65-2(e)]

Question 7.3.40 What is the adoption date if the retrospective method of adoption is elected?

Interpretive response: The retrospective method adoption date the entity elects can be no earlier than the earliest issue year for which the entity has actual experience information for all in-scope contracts in force for that issue year and all subsequent issue years. For further discussion, see Question 7.3.10 and Example 7.3.10. [944-40-65-2(e)]

Question 7.3.50 What is the transition guidance for periods before the adoption date if the retrospective method of adoption is elected?

Interpretive response: Under the retrospective method, the contract issue date for all contracts in force at transition may precede the retrospective method adoption date. In this situation, an entity uses the modified retrospective method for those years before the retrospective method adoption date. For further discussion, see Question 7.3.10 and Example 7.3.10. [944-40-65-2(e)]

Question 7.3.60 What is the unit of account used in transition?

Interpretive response: The unit of account used in transition to calculate the liability for future policy benefits is consistent with the unit of account used after transition. An entity uses the same groups that are used to calculate the liability for future policy benefits under ASU 2018-12. [944-40-65-2(f)]

To calculate the liability for future policy benefits, an entity cannot group contracts together from different original contract issue years. See further discussion about contract groups in section 2.2.10. [944-40-65-2(d)]

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Observation Challenges with 'telling your story'

An entity may want to begin thinking about how it will tell its story after the adoption of ASU 2018-12. Understanding how management wants to explain the entity's results to key stakeholders may influence the determination of contract groupings to calculate the liability for future policy benefits and the (dis)aggregation decisions for disclosures.

An entity may also need to educate internal stakeholders and analysts about the key changes under ASU 2018-12 to get ahead of any confusion about how the changes will affect reported results.

Observation Carryover basis considerations

Legacy US GAAP did not require the recognition of certain liabilities at a disaggregated level – e.g. incremental liabilities for loss recognition and profits followed by losses. An entity may have recognized these additional liabilities at a more aggregated level than the contract groups it uses to calculate the liability for future policy benefits under ASU 2018-12.

The transition guidance in ASU 2018-12 does not prescribe the manner in which an entity should disaggregate these historical incremental liabilities to the current contract groups to determine the carryover basis of the future policy benefit reserve. At transition, we believe an entity needs to develop a systematic and rational method to allocate any incremental reserves recognized to the contract groups under ASU 2018-12. This disaggregation could cause the expected ratio of net premiums to gross premiums for some contract groupings to exceed 100%. For further discussion about the effect on the financial statements at transition, see Question 7.3.70.

Further, an entity should disclose the allocation method used. [944-40-65-2(g)(2)]

Question 7.3.65 Are expense assumptions reviewed at transition when using the modified retrospective method of adoption?

Interpretive response: Yes. When using the modified retrospective method of adoption, an entity reviews the cash flow assumptions for grouped contracts at the transition date. The cash flow assumptions reviewed include expense assumptions. An entity updates its cash flow assumptions for grouped contracts at transition, if needed. This expense assumption review is performed regardless of whether the entity-wide election to not update expense assumptions is made after adoption. [944-40-65-2(d)(2), 35-5(a)(2)]

For subsequent measurement, an entity can make an entity-wide election to not update expense assumptions. For further discussion about expense assumptions, see section 2.3.30.

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Question 7.3.68 Is the difference in the net premium ratio using legacy US GAAP and ASU 2018-12 immediately recognized under the modified retrospective method of transition?

Interpretive response: No. An entity recognizes in future periods any difference between the net premium ratio used to calculate:

- the pre-transition carrying amount of the liability; and
- the liability for future policy benefits at transition, using updated cash flow assumptions and the discount rate immediately before the transition date (Legacy Discount Rate).

ASU 2018-12 does not provide transition guidance for situations in which a negative net premium ratio is calculated at transition. The negative net premium ratio reduces the liability prospectively to the amount needed for future benefit payments. This could result when the carryover basis liability exceeds the present value of future benefits and expenses using updated cash flow assumptions – i.e. the pre-transition liability is greater than the amount needed to fund future benefits as measured under ASU 2018-12. As such, an entity should follow the transition guidance and recognize this difference prospectively in future periods. [944-40-65-2]

For further discussion about the expected ratio of net premiums to gross premiums exceeding 100% at transition, see Question 7.3.70.

Question 7.3.70 Can the expected ratio of net premiums to gross premiums exceed 100% at transition?

Interpretive response: No. The expected ratio of net premiums to gross premiums at the contract group level cannot exceed 100% at transition. For traditional contracts, the amount above 100% is recognized as an adjustment to opening retained earnings. For limited-payment contracts, the amount above 100% reduces the DPL to zero and any remaining amount is recognized as an adjustment to opening retained earnings. [944-40-65-2(d)(3)]

Question 7.3.75 Is the carryover basis adjusted at transition to remove shadow adjustments?

Interpretive response: It depends. ASU 2018-12 eliminates the requirement for premium deficiency or loss recognition testing for the liability for future policy benefits for traditional and limited-payment contracts. As such, shadow accounting no longer applies for these contracts. Therefore, at transition, any shadow adjustments for the liability for future policy benefits for traditional and limited-payment contracts are reversed with the offset recorded as an adjustment to opening AOCI. An entity makes this reversal before calculating the net premium ratio and carryover basis of the liability for future policy benefits on the transition date. [944-60-15-5, 944-40-65-2(c)]

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However, because shadow accounting still applies under ASU 2018-12 for the following policies, the carryover basis of the liability is not adjusted at transition to remove shadow adjustments: [944-40-60-15-5, 944-40-25-27A]

- participating life insurance policies meeting the requirements of paragraph 944-20-15-3, and
- universal life-type contracts and nontraditional contract benefits where an entity considers investment performance in measuring the additional liability for death or other insurance benefits when the amounts assessed against the contract holder result in profits followed by losses.

For further discussion about shadow accounting for reserves, see Question 5.3.30.

Question 7.3.80 Is the carryover basis adjusted at transition to remove policy maintenance expenses and PADs?

Interpretive response: No. The carryover basis at transition is not adjusted to remove previous policy maintenance expenses and PADs. After transition: [944-40-30-15]

- policy maintenance expenses are charged to expense as incurred and are not included in the expense assumptions used to estimate the liability for future policy benefits; and
- assumptions used to calculate the liability for future policy benefits should not include a PAD.

For further discussion about maintenance expenses, see Question 2.3.70.

Question 7.3.81 Is the carryover discount rate adjusted at transition to remove PADs when using the modified retrospective method of transition?

Interpretive response: No. Under legacy US GAAP, entities may have applied a PAD to the discount rate used to calculate the liability for future policy benefits. Under the modified retrospective method of transition, an entity retains the pre-transition discount rate assumption used to calculate the liability immediately before transition when determining the net premium ratio and subsequent interest accretion. Therefore, under the modified retrospective method of transition, an entity retains the carryover discount rate at transition without adjusting for any PADs included under legacy US GAAP. [944-40-65-2(d)(1)]

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Question 7.3.84 Can an entity change its method for determining the discount rate assumption at transition when using the modified retrospective method of transition?

Interpretive response: No. Under the modified retrospective method of transition, an entity carries over the pre-transition liability for future policy benefits, adjusted for the removal of any amounts in AOCI. At transition, we believe an entity carries over the method selected to determine the discount rate assumption used to measure the pre-transition liability for future policy benefits – e.g. spot rate, forward rate, single equivalent rate. As such, we do not believe an entity can change its method for determining the locked-in discount rate assumption used to determine income statement interest accretion when using the modified retrospective method of transition. For example, we do not believe that an entity can change between a method that uses a curve and a single equivalent rate method. [944-40-65-2(c)]

Question 7.3.85 What discount rate assumption is retained when using a modified retrospective method of transition?

Interpretive response: Under legacy US GAAP, the liability for future cash payments on a long-duration traditional insurance contract – including disability and long-term care contracts when claims are expected to be paid over an extended period of time after the claim is incurred – consisted of two separate liability components:

- future policy benefits (claims not yet incurred); and
- unpaid claim and claim adjustment expenses (incurred claims not yet paid).

These two separate liability components may have been calculated using separate distinct discount rates.

Under ASU 2018-12, an entity calculates a single liability for future policy benefits that comprises all expected cash flows under the contract, including expected future cash flow payments for claims incurred. [944-40-25-8, 25-11, 30-7, 35-6A]

When using a modified retrospective method of transition, ASU 2018-12 requires that an entity retain the discount rate assumption used to calculate the liability immediately before transition for purposes of determining the net premium ratio and subsequent interest accretion. This requirement applies to each of the two separate liability components under legacy US GAAP. [944-40-65-2(d)(1)]

The transition guidance in ASU 2018-12 does not prescribe the manner in which the separate discount rates are retained when performing the single liability calculation. At transition, an entity develops an approach to determine the retained discount rate(s). Possible approaches include retaining the separate distinct discount rates or computing a weighted-average rate for the combined cash flows.

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This discount rate is used to compare to the current ASU 2018-12 discount rate (upper-medium-grade [low-credit-risk] fixed-income instrument yield) at the transition date when determining the balance recorded to opening AOCI. [944-40-65-2(d)(4)]

For further discussion about the single liability for future policy benefits, see Question 2.3.85.

Question 7.3.90 Are there specific transition considerations for limited-payment contracts?

Interpretive response: Yes. For limited-payment contracts, an entity first compares the ratio of expected net premiums to expected gross premiums at transition. Then, the liability for future policy benefits is adjusted at the transition date to remove any related amounts in AOCI. [944-40-65-2(n) – 65-2(p)]

Subsequently, if the resulting liability for future policy benefits measured using updated assumptions at the transition date is: [944-40-65-2(n) – 65-2(p)]

- **Greater than the carrying amount before transition *and* expected net premiums *exceed* expected gross premiums**, an entity sets net premiums equal to gross premiums by reducing the DPL with an offsetting increase to the liability for future policy benefits. If a further increase to the liability for future policy benefits is required, that amount is recognized in opening retained earnings.
- **Greater than the carrying amount before transition but the expected net premiums are *less than* expected gross premiums**, an entity reduces the DPL for the difference with an offsetting increase to the liability for future policy benefits. No additional increase in the liability for future policy benefits is recognized. No amounts are recognized in opening retained earnings.
- **Less than the carrying amount before transition**, an entity increases the DPL for the difference with a corresponding decrease in the liability for future policy benefits.

Question 7.3.92 What is the carryover discount rate for single-payment contracts that used a break-even discount rate under legacy US GAAP when applying the modified retrospective method of transition?

Interpretive response: Under the modified retrospective method of transition, we believe an entity eliminates its use of a break-even discount rate. We believe the entity then determines the discount rate to be used for interest accretion immediately prior to the transition date.

For contracts without a historical loss recognition event, we believe the discount rate is the locked-in discount rate at contract issuance determined under paragraph 944-40-30-9 (prior to being amended by ASU 2018-12). Under

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legacy US GAAP, this guidance required that the discount rate used to estimate the liability for future policy benefits be based on estimates of investment yields (net of related investment expenses) expected at contract issuance. In this situation, we believe an entity develops a systematic and rational method to determine the discount rate at contract issuance. For contracts with a historical loss recognition event, we believe the entity uses the discount rate established at the date of the loss recognition event without adjustment. [944-40-65-2(d)]

Under legacy US GAAP, some entities used a simplified method by measuring single premium limited-payment contracts using a break-even discount rate that resulted in the recognition of an implicit deferred profit liability within the liability for future policy benefits. This rate was calculated by finding the discount rate that caused the initial liability to equal the net consideration (i.e. the gross premium less acquisition costs).

Under ASU 2018-12, the liability for future policy benefits is measured differently from the deferred profit liability. They are both retrospectively remeasured for subsequent changes in actual and expected cash flows. However, the deferred profit liability is not remeasured for changes in the discount rate assumption. Alternatively, the liability for future policy benefits is remeasured for changes in the discount rate assumptions, with those changes recognized in OCI. Therefore, explicit discount rates for the liability for future policy benefits and the deferred profit liability are needed. [944-40-35-6A(b)(1), 944-605-35-1C(c)]

Question 7.3.95 Are there specific transition considerations for the additional liability for death or other insurance benefits or annuitization benefits under the modified retrospective method of transition?

Interpretive response: No. ASU 2018-12 does not provide transition guidance for situations where:

- an entity measured its additional liability for death or other insurance benefits or annuitization benefits under legacy US GAAP by including expected investment margins on balances other than those earned from the investment of policyholder balances; or
- the change in the amortization method of the URR to the simplified amortization method under ASU 2018-12 results in a change to the assessments used to measure the additional liability for death or other insurance benefits or annuitization benefits.

Change in expected investment margins

Because of the lack of transition guidance, under the modified retrospective method of transition, we believe a change to the measurement of the additional liability for death or other insurance benefits or annuitization benefits resulting from a change in the expected investment margins represents a change in accounting principle effected to adopt the requirements of ASU 2018-12 under Topic 250. Therefore, an entity retrospectively applies the accounting under the ASU with the cumulative effect of the change to periods prior to the first period

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presented recorded as of the beginning of the first period presented with an adjustment to opening retained earnings at the transition date. [250-10-45-3 – 45-5]

For contracts with assets in the general account, an entity includes the investment margin with other assessments to calculate total expected assessments in the benefit ratio. ASU 2018-12 clarifies that the investment margin is the amount expected to be earned from the investment of policyholder balances less amounts credited to policyholder balances. Under legacy US GAAP, some entities included investment margins from assets supporting the additional liability that are not policyholder balances. For additional guidance on annuitization benefits, see section 2.5.20. For additional guidance on death or other insurance benefits, see section 2.5.30. [944-40-25-14, 944-40-30-22, 944-40-30-27]

Change in amortization method of URR

Because of the lack of transition guidance, under the modified retrospective method of transition, we believe a change to the amortization method of URR represents a change subsequent to transition with no adjustment recorded at the transition date. The change to the assessments used to measure the additional liability for the amortization method of URR is recorded in the financial statements subsequent to the transition date.

URR follows the simplified DAC amortization method in ASU 2018-12, including the related transition guidance. Under the modified retrospective method of transition, an entity carries over the pre-transition URR, adjusted for the removal of any amounts in AOCI. For additional guidance on URR, see section 5.5. [944-40-65-2(c), 944-605-35-2]

For further guidance, see KPMG Handbook, Accounting changes and error corrections.

Example 7.3.10 Retrospective adoption – earliest period with actual historical information

ABC Corp. is a calendar year-end registrant that is not eligible to be a smaller reporting company and is adopting ASU 2018-12 at the effective date (i.e. January 1, 2023).

ABC aggregates policies into annual contract groups for similar products to measure its liability for future policy benefits. For the purpose of measuring the contract liability for the initial contract issuance year and all subsequent issue years, ABC concluded that the products it began writing in:

- 2015 would be separated into three separate contract groups.
- 2016 would be aggregated into a single contract group.

ABC evaluates the availability of actual historical experience information for each of its four contract groups.

Contract group	Date actual historical experience information is available
Contract group A	For 2015 and each subsequent year
Contract group B	For 2017 and each subsequent year

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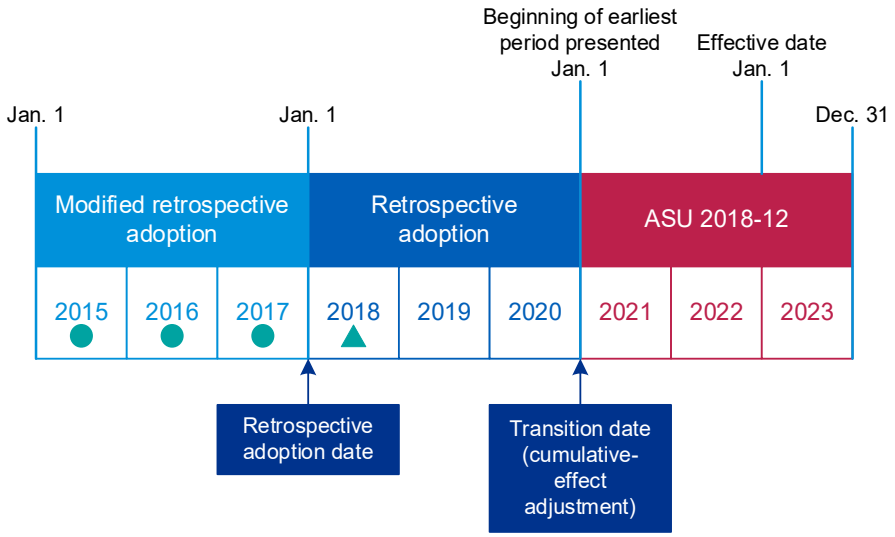
Contract group	Date actual historical experience information is available
Contract group C	For 2018 and each subsequent year
Contract group D	For 2016 and each subsequent year

The first issue year for which actual historical experience information is available for all contract groups is 2018. Therefore, the earliest that ABC can elect to use the retrospective transition method is January 1, 2018. ABC selects this date as its retrospective adoption date.

On the transition date, ABC measures the liability for future policy benefits by:

- applying the guidance in ASU 2018-12 for all contract groups originally issued in and after 2018; and
- using the modified retrospective adoption method at January 1, 2021 for all contract groups originally issued during years 2015 – 2017.

The following timeline demonstrates this fact pattern.



Example 7.3.20 Retrospective adoption – other date

Assume the same facts as in Example 7.3.10 except that ABC selects January 1, 2020 as its retrospective adoption date even though it has the actual historical experience information to be able to go back further.

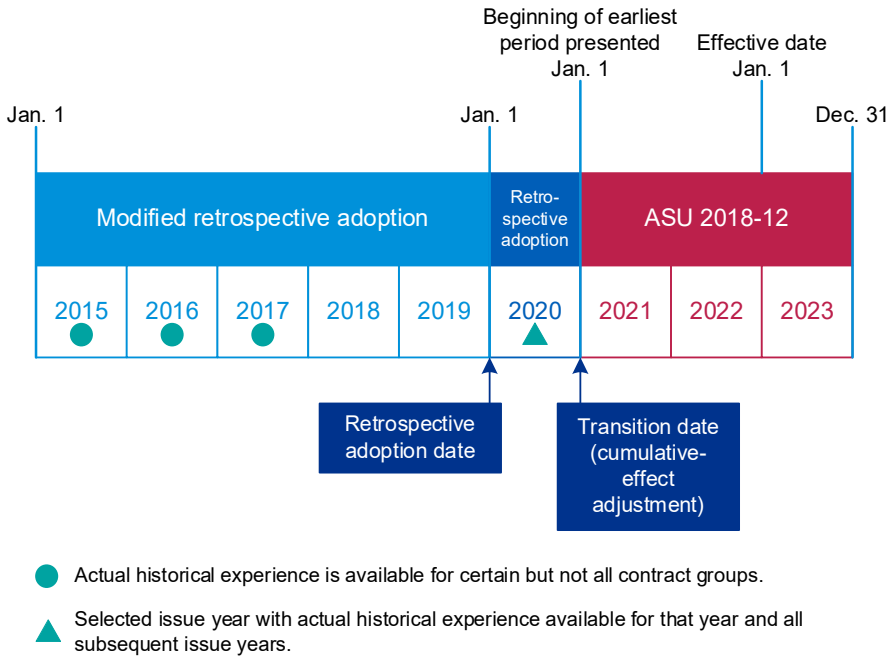
On the transition date, ABC measures the liability for future policy benefits by:

- applying the guidance in ASU 2018-12 for all contract groups originally issued in and after 2020; and

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- using the modified retrospective adoption method at January 1, 2021 for all contract groups originally issued during years 2015 – 2019.

The following timeline demonstrates this fact pattern.



Example 7.3.30 Modified retrospective transition

Life Insurer writes 10-year term life insurance.

Under legacy US GAAP, Life Insurer calculated the net premium ratio at contract issuance. That net premium ratio was locked in and used to calculate the liability for future policy benefits at each subsequent reporting period. The locked-in discount rate was 5%. Life Insurer calculated the net premium ratio at issuance using the following projected future cash flows to develop the net premium ratio used to record the liability for future policy benefits under legacy US GAAP.

For illustrative purposes, this example assumes no lapses and no expenses. In addition, the numbers in this example are rounded.

Legacy US GAAP at contract issuance						
Policy year	**Projected premiums (a)**	**Projected claims (b)**	**Liability[1]**	**Change in liability[2]**	**Interest accretion[3]**	**Change in earnings[4]**
1	100,000	40,000	22,934	22,934	-	(22,934)
2	100,000	50,000	37,016	14,082	1,147	(14,082)
3	100,000	50,000	51,801	14,785	1,851	(14,785)

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Legacy US GAAP at contract issuance						
Policy year	**Projected premiums (a)**	**Projected claims (b)**	**Liability[1]**	**Change in liability[2]**	**Interest accretion[3]**	**Change in earnings[4]**
4	100,000	60,000	57,325	5,524	2,590	(5,524)
5	100,000	60,000	63,126	5,801	2,866	(5,801)
6	100,000	70,000	59,217	(3,909)	3,156	3,909
7	100,000	70,000	55,112	(4,105)	2,961	4,105
8	100,000	80,000	40,802	(14,310)	2,756	14,310
9	100,000	80,000	25,777	(15,025)	2,040	15,025
10	100,000	90,000	-	(25,777)	1,289	25,777
Present value at contract issuance of projected gross premium cash flows, discounted at locked-in discount rate of 5% (column A for all policy years) (c)						772,173
Present value at contract issuance of projected claim cash flows, discounted at locked-in discount rate of 5% (column B for all policy years) (d)						485,963
Net premium ratio at issue (d ÷ c)						62.93%

Notes:

1. The liability balance at the end of each policy year is calculated as:

   (net present value of projected claims for all future policy years using the locked-in discount rate of 5%) – [(net premium ratio at issue of 62.93%) × (net present value of projected gross premiums for all future policy years using the locked-in discount rate of 5%)].
2. The change in liability balance for each policy year is calculated as the current end of period liability balance less the prior end of period liability balance.
3. The interest accretion for each policy year is calculated as the prior end of period liability balance × the locked-in discount rate of 5%. This amount is embedded in the change in liability balance but is shown separately for illustrative purposes.
4. The change in earnings for each policy year is shown for illustrative purposes and is the increase (decrease) to earnings for the change in the liability during the year.

Life Insurer adopts ASU 2018-12 on the mandatory effective date using the modified retrospective transition method at the transition date (beginning of Policy Year 6). Actual contract experience at transition is consistent with projected experience at contract issuance. The carrying amount of the liability for future policy benefits immediately before transition is $63,126 (the liability balance at the end of Policy Year 5). The legacy discount rate of 5% is the locked-in discount rate at the transition date.

At transition, Life Insurer updates its expectations of future cash flow assumptions for the remaining policy years to reflect management's best estimates as follows.

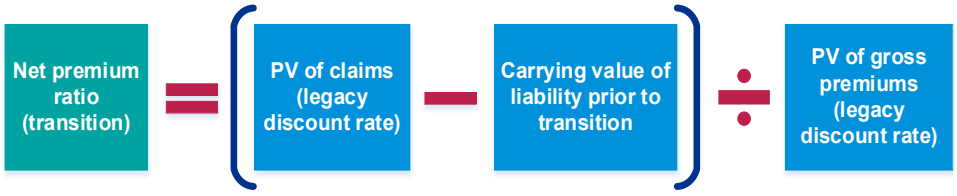
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Updated projected future cash flow assumptions		
Policy year	**Projected premiums (e)**	**Projected claims (f)**
6	100,000	70,000
7	100,000	75,000
8	100,000	85,000
9	100,000	85,000
10	100,000	100,000

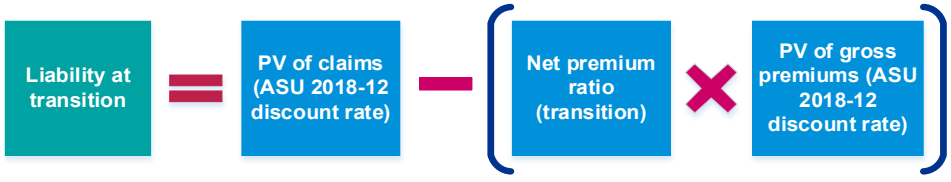
Life Insurer calculates the present value of the updated projected future cash flows using both the legacy discount rate (5%) (locked-in) and the current ASU 2018-12 discount rate (4%) as follows.

Present value of projected future cash flows		
Cash flows	**At legacy discount rate (5%)**	**At ASU 2018-12 discount rate (4%)**
Projected gross premium cash flows (sum of entries in column e for all policy years) (g)	432,948	445,182
Projected claim cash flows (sum of entries in column f for all policy years) (h)	356,402	367,064

Life Insurer uses the calculated present value of projected future cash flows (legacy discount rate) to calculate the net premium ratio at transition of 67.74% [($356,402 – $63,126) ÷ $432,948] as follows.



Life Insurer uses the calculated net premium ratio at transition and the present value of projected future cash flows (ASU 2018-12 current discount rate) to calculate the liability at transition of $65,498 [$367,064 – (67.74% × $445,182)] as follows.



Life Insurer uses the calculated liability at transition to determine the AOCI impact at transition. This is the difference between the liability calculated using the legacy discount rate at transition and the ASU 2018-12 current discount rate. The AOCI impact at transition is calculated as follows.

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AOCI impact at transition	
Liability at transition (using ASU 2018-12 current discount rate)	65,498
Less: Liability before transition (using legacy discount rate)	63,126
AOCI impact at transition ($65,498 – $63,126)	2,372

As of the transition date, Life Insurer records the following journal entry.

	Debit	Credit
AOCI	2,372	
Liability for future policy benefits		2,372
To record transition adjustment for difference in discount rate pre- and post-transition.		

See Example 2.2.20 for guidance on the recalculation of net premium ratio after adoption using this same fact pattern.

Example 7.3.40 Retrospective transition

Life Insurer writes 10-year term life insurance.

Under legacy US GAAP, Life Insurer calculated the net premium ratio at contract issuance. That net premium ratio was locked in and used to calculate the liability for future policy benefits at each subsequent reporting period. The locked-in discount rate was 5%.

Life Insurer calculated the net premium ratio at contract issuance using the following projected future cash flows. That net premium ratio was used to record the liability for future policy benefits under legacy US GAAP.

For illustrative purposes, this example assumes no lapses and no claim settlement expenses. In addition, the numbers in this example are rounded.

Legacy US GAAP at contract issuance						
Policy year	**Projected premiums (a)**	**Projected claims (b)**	**Liability[1]**	**Change in liability[2]**	**Interest accretion[3]**	**Change in earnings[4]**
1	100,000	40,000	22,934	22,934	-	(22,934)
2	100,000	50,000	37,016	14,082	1,147	(14,082)
3	100,000	50,000	51,801	14,785	1,851	(14,785)
4	100,000	60,000	57,325	5,524	2,590	(5,524)
5	100,000	60,000	63,126	5,801	2,866	(5,801)
6	100,000	70,000	59,217	(3,909)	3,156	3,909
7	100,000	70,000	55,112	(4,105)	2,961	4,105
8	100,000	80,000	40,802	(14,310)	2,756	14,310

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Legacy US GAAP at contract issuance						
Policy year	**Projected premiums (a)**	**Projected claims (b)**	**Liability[1]**	**Change in liability[2]**	**Interest accretion[3]**	**Change in earnings[4]**
9	100,000	80,000	25,777	(15,025)	2,040	15,025
10	100,000	90,000	-	(25,777)	1,289	25,777
Present value at contract issuance of projected gross premium cash flows, discounted at locked-in discount rate of 5% (column a for all policy years) (c)						772,173
Present value at contract issuance of projected claim cash flows, discounted at locked-in discount rate of 5% (column b for all policy years) (d)						485,963
Net premium ratio at issue (d ÷ c)						62.93%

Notes:

1. The liability balance at the end of each policy year is calculated as:

   (net present value of projected claims for all future policy years using the locked-in discount rate of 5%) – [(net premium ratio at issue of 62.93%) × (net present value of projected gross premiums for all future policy years using the locked-in discount rate of 5%)].
2. The change in liability balance for each policy year is calculated as the current end of period liability balance less the prior end of period liability balance.
3. The interest accretion for each policy year is calculated as the prior end of period liability balance × the locked-in discount rate of 5%. This amount is embedded in the change in liability balance, but is shown separately for illustrative purposes.
4. The change in earnings for each policy year is shown for illustrative purposes and is the increase (decrease) to earnings for the change in the liability during the year.

Life Insurer adopts ASU 2018-12 at the beginning of Policy Year 6 on the transition date. Life Insurer determined that it had actual historical experience information for all policy years back to contract issuance. Life Insurer elected to adopt ASU 2018-12 using the retrospective transition method.

At transition, Life Insurer updates the projected future cash flow assumptions by:

- substituting actual historical premiums and claims for those periods before the transition date; and
- updating projected future cash flow assumptions for periods after the transition date.

Updated future cash flow assumptions		
Policy year	**Premiums (e)**	**Claims (f)**
1	100,000	50,000
2	100,000	60,000
3	100,000	60,000
4	100,000	70,000

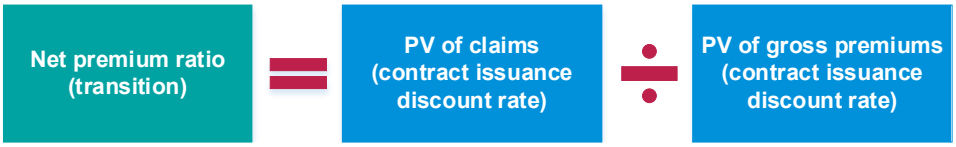
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Updated future cash flow assumptions		
Policy year	**Premiums (e)**	**Claims (f)**
5	100,000	70,000
6	100,000	70,000
7	100,000	75,000
8	100,000	85,000
9	100,000	85,000
10	100,000	100,000

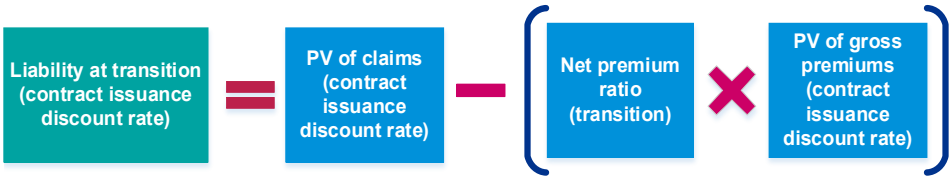
Life Insurer determined that the discount rate at contract issuance based on an upper-medium grade fixed-income security is 5%. Life Insurer calculates the present value of the updated future cash flows using both the contract issuance discount rate (5%) and the transition discount rate (4%) as follows.

Present value of future cash flows		
Cash flows	**At contract issuance discount rate (5%)**	**At transition discount rate (4%)**
Premium cash flows (sum of entries in column e for all policy years)	772,173	
Claim cash flows (sum of entries in column f for all policy years)	545,558	
Projected gross premium cash flows (sum of entries in column e for Policy Years 6 to 10)	432,948	445,182
Projected claim cash flows (sum of entries in column f for Policy Years 6 to 10)	356,402	367,064

Life Insurer uses the calculated present value of future cash flows (all policy years) (contract issuance discount rate) to calculate the net premium ratio at transition of 70.65% [545,558 ÷ 772,173] as follows.



Life Insurer uses the calculated net premium ratio (transition) and the present value of projected future cash flows (Policy Years 6 to 10 at the contract issuance discount rate) to calculate the contract issuance discount rate liability at transition of $50,524 [$356,402 − (70.65% × $432,948)] as follows.



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Life Insurer uses the calculated net premium ratio at transition and the present value of projected future cash flows (Years 6 to 10 at the transition discount rate) to calculate the current transition date liability of $52,543 [$367,064 – (70.65% × $445,182)] as follows.



Life Insurer calculates the change in the liability because of the retrospective contract issuance update of future cash flow projections. This calculation is performed using the liability at transition measured with the contract issuance discount rate. This change is recorded in opening retained earnings at transition.

Change in the liability – updated projections (Retained earnings)	
Liability at transition (using contract issuance discount rate and updated projected future cash flow assumptions)	50,524
Less: Liability before transition (carrying balance at end of Year 5)	63,126
Opening retained earnings impact at transition ($50,524 – $63,126)	(12,602)

Life Insurer then calculates the change in the liability because of the discount rate update – i.e. from the contract issuance discount rate to the transition discount rate. This change is recorded in AOCI at transition.

Change in the liability – discount rate update (AOCI)	
Liability at transition (using current transition discount rate and updated projected future cash flow assumptions)	52,543
Less: Liability at transition (using contract issuance discount rate and updated projected future cash flow assumptions)	50,524
AOCI impact at transition ($52,543 – $50,524)	2,019

As of the transition date, Life Insurer records the following journal entry.

	Debit	Credit
Liability for future policy benefits[1]	10,583	
AOCI	2,019	
Retained earnings		12,602
To record retrospective transition adjustment at transition.		

Note:

1. Validated as the difference between the liability at transition (using current transition discount rate) and the liability after transition ($52,543 – $63,126).

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7.3.40 Deferred acquisition costs

An entity applies ASU 2018-12 to DAC using the existing carryover basis on the transition date. The carryover basis is adjusted to remove related amounts in AOCI. [944-40-65-2(e)(1)]

Similar to the liability for future policy benefits, an option exists to apply the guidance retrospectively, with a cumulative-effect adjustment to opening retained earnings. The availability of historical information may limit the use of retrospective adoption for all issue years. [944-40-65-2(e)(1)]

The transition method and issue-year level used for DAC must be consistent with what is used for the liability for future policy benefits. [944-40-65-2(e)]

Question 7.3.100 What is the transition method for DAC?

Interpretive response: ASU 2018-12 requires a modified retrospective adoption method unless the criteria to retrospectively adopt are met *and* the retrospective method is elected. However, ASU 2018-12 requires an entity to use the same transition method for DAC and the liability for future policy benefits. [944-40-65-2(e)(1)]

If an entity elects to measure the liability for future policy benefits for certain contract groups at transition using retrospective adoption, the entity also applies the retrospective adoption method to calculate the DAC balance at transition for those same contract groups. The DAC balance is calculated at the retrospective adoption date using the simplified amortization method in ASU 2018-12 to determine the transition date balance. For further discussion about transition methods, see Question 7.3.10. For further discussion about using historical information under the retrospective method of adoption, see Question 7.3.30. [944-40-65-2(e)(2)]

Question 7.3.110 Is a transition adjustment recognized for DAC?

Interpretive response: At transition under both the modified retrospective adoption method and the retrospective adoption method, the DAC balance is updated to remove any amounts recognized in AOCI (e.g. shadow adjustments). This is done following the same guidance as the liability for future policy benefits. If the retrospective method of adoption is applied, there will be additional transition adjustments to DAC. [944-40-65-2(c)]

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Question 7.3.120 Is the DAC balance at transition adjusted for the effects of adopting the MRB guidance when using a modified retrospective method of transition for DAC?

Interpretive response: Maybe. Under legacy US GAAP, the DAC balance was amortized using amortization models linked to revenue or profit of the related insurance contracts – e.g. premiums, gross profits or gross margins. At transition under the modified retrospective method of transition, an entity uses the existing carryover DAC balance updated to remove any amounts recognized in AOCI (e.g. shadow adjustments). [944-40-65-2(c)]

ASU 2018-12 requires a retrospective adoption method for MRBs. We do not believe that the retrospective adoption for MRBs requires an entity to update the legacy US GAAP amortization model before transition. [944-40-65-2(f)]

We believe an entity using the modified retrospective method of transition for DAC can either: [944-40-35-8B, 65-2(c)]

- carryforward the pre-transition DAC balance, updated to remove any amounts recognized in AOCI, consistent with the DAC transition guidance. Any adjustment to amortize existing DAC because the contract(s) account balance is extinguished is recognized immediately in income subsequent to transition; or
- revise the historical estimated gross profits (amount and pattern) used to amortize DAC to reflect the retrospective method of transition for MRBs and any adjustment to the amortization period because the contract(s) account balance is extinguished. An entity would use these revised estimated gross profits to revise the historical DAC amortization with any resulting change recognized as an adjustment to opening retained earnings at transition.

When using the modified retrospective method of transition, we believe an entity should apply its DAC transition approach on an entity-wide basis. Further, we believe it should disclose its elected approach. [944-40-65-2(g)(2), 65-2(h)(2)]

If an entity meets the criteria to retrospectively adopt (see Questions 7.3.10 and 7.3.100) *and* elects the retrospective method of transition for DAC, we believe the amortization model should be updated retrospectively during the retrospective adoption period using the simplified DAC amortization model. This includes reversing any historical DAC impairment, interest charged and capitalized expenses that are to be expensed as incurred under ASU 2018-12. [944-40-65-2(e)]

Question 7.3.130 Is the carryover basis of DAC adjusted at transition to remove future commissions not yet incurred?

Interpretive response: Under the modified retrospective adoption method, ASU 2018-12 requires that an entity carry over the existing DAC balance on the

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transition date. At transition, an entity updates the DAC balance to remove any amounts recognized in AOCI. However, ASU 2018-12 does not allow an entity to update the carryover basis at transition to remove future renewal commissions (not yet incurred) that were previously included in DAC. For further discussion about the accounting for DAC, see chapter 4. [944-40-65-2(c)]

Question 7.3.140 Can an entity with only participating life insurance contracts adopt the simplified DAC amortization guidance under the retrospective method of transition?

Interpretive response: Yes. ASU 2018-12 requires that the transition method and issue-year level used for DAC be consistent with the transition method used for the liability for future policy benefits. However, participating contracts are not in the scope of the liability for future policy benefits guidance in ASU 2018-12. Therefore, the above requirement to use a consistent transition method is not applicable. We believe that an entity with only participating life insurance contracts can adopt the simplified DAC amortization guidance under the retrospective method of transition. [944-40-65-2(b)]

7.4 Transition – MRBs

7.4.10 Overview

Excerpt from ASC 944-40

> Transition Related to Accounting Standards Updates No. 2018-12, *Financial Services–Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, No. 2019-09, *Financial Services–Insurance (Topic 944): Effective Date*, and No. 2020-11, *Financial Services-Insurance (Topic 944): Effective Date and Early Application*

65-2 The following represents the transition and effective date information related to Accounting Standards Updates No. 2018-12, *Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts,* No. 2019-09*, Financial Services—Insurance (Topic 944): Effective Date,* and No. 2020-11*, Financial Services—Insurance (Topic 944): Effective Date and Early Application: …*

Market risk benefits

f. At the transition date, an insurance entity shall apply the pending content that links to this paragraph on **market risk benefits** by means of retrospective application to all prior periods. An insurance entity shall maximize the use of relevant observable information as of contract inception and minimize the use of unobservable information in determining the market risk benefits balance at the transition date. If retrospective application requires assumptions in the prior period that are unobservable

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or otherwise unavailable and cannot be independently substantiated, the insurance entity may use hindsight in determining those assumptions. The transition adjustment shall be recognized as follows:

1. The cumulative effect of changes in the instrument-specific credit risk between contract issue date and transition date shall be recognized in accumulated other comprehensive income as of the transition date.
2. The difference between **fair value** and carrying value at the transition date, excluding the amount in (f)(1), shall be recognized as an adjustment to the opening balance of retained earnings as of the transition date.

7.4.20 Retrospective adoption

The accounting for MRBs should be applied on a retrospective basis at the transition date. [944-40-65-2(f)]

An entity will need to: [944-40-65-2(f)]

- analyze each contract to identify all MRBs;
- review the terms of the MRB(s);
- determine the assumptions used to calculate fair value by maximizing relevant observable information, including determining the attributed fee at contract issuance if the nonoption valuation approach is elected;
- calculate the fair value at the transition date;
- recognize an adjustment at the transition date.

The accounting for MRBs should follow the guidance in chapter 3. Determining the assumptions at original contract issuance requires judgment and an evaluation of the availability and relevance of observable data. [944-40-65-2(f)]

Question 7.4.10 How is the change in instrument-specific credit risk recognized?

Interpretive response: The cumulative effect of changes in the instrument-specific credit risk between contract issue date and transition date is recognized in AOCI. [944-40-65-2(f)(1)]

Question 7.4.20 How is the difference between the fair value and carryover basis recognized at transition?

Interpretive response: The difference between the fair value and carryover basis at the transition date, excluding the change in instrument-specific credit risk, is recognized as an adjustment to opening retained earnings. The change in instrument-specific credit risk is recognized as an adjustment to opening AOCI. [944-40-65-2(f)(2)]

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Question 7.4.21 Is the current definition of fair value used for MRBs under the retrospective method of transition?

Interpretive response: Yes. ASU 2018-12 requires that all MRBs be measured at fair value. Topic 820 defines 'fair value' as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date'. Topic 944 uses the same definition. [944-40-30-19C, 944-40-20 Glossary]

Under this definition, the fair value of a liability reflects nonperformance risk: "the risk that an entity will not fulfill an obligation…includes, but may not be limited to, the reporting entity's own credit risk." [820-10-20 Glossary, 820-10-35-7]

Under ASU 2018-12, the accounting for all MRBs is applied on a retrospective basis as of contract issuance. An entity calculates the fair value of each MRB at the transition date using the assumptions at original contract issuance and the current Topic 820 definition of fair value (not the definition of fair value in place at contract issuance). [944-40-65-2(f)]

An entity does not consider the definition of fair value at original contract issuance. FASB Statement No. 157 (FAS 157) was effective for fiscal years beginning after November 15, 2007 and was codified into Topic 820. FAS 157 introduced the consideration of nonperformance risk in determining fair value.

Question 7.4.25 Are intangible assets recognized in a pre-transition business combination affected by the retrospective adoption of MRBs?

Interpretive response: Maybe. Before the transition date, an entity may have amortizable intangible assets acquired in a business combination related to insurance or reinsurance contracts – e.g. VOBA or PVFP. Additionally, the accounting for MRBs is applied on a retrospective basis at the transition date. [944-40-65-2(f)]

ASU 2018-12 does not change the business combination's fair value or the fair value of the acquired insurance or reinsurance contracts. As such, an entity will need to determine if the retrospective adoption of MRBs results in a change to the initial calculated amortizable intangible asset (at the pre-transition business combination date) for insurance and reinsurance contracts acquired. This determination considers:

- the value of the newly created MRB contract or contract feature as of the date of the business combination; and
- any impacts on other components of the valuation of the amortizable intangible asset on the date of the business combination, including the elimination of any liability for the MRB contract or contract feature previously recorded under the insurance benefit model – sometimes referred to as the SOP 03-1 model.

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If there is a change in the initial calculated amortizable intangible asset for insurance and reinsurance contracts acquired, an entity will need to determine whether there is a change to the amount of related amortization recorded before the transition date. We believe the entity's amortization method to calculate this adjustment is consistent with its amortization method prior to adoption of ASU 2018-12. [944-40-65-2(e)(1)]

Question 7.4.26 Is the classification of a pre-transition reinsurance contract affected by the retrospective adoption of MRBs?

Interpretive response: No. Before the transition date, an entity may have entered into a reinsurance contract that included underlying insurance contracts or contract features that meet the definition of MRBs. At contract inception, the entity evaluated whether the contract met the definition of reinsurance because it indemnified the ceding entity against loss or liability relating to insurance risk. [944-20-15-37]

Under ASU 2018-12, the accounting for MRBs is applied on a retrospective basis at the transition date. We do not believe that the accounting for MRBs on a retrospective basis at the transition date permits the reinsurance contract's classification to be reassessed – i.e. insurance contract versus investment contract. [944-40-25-25C, 65-2(f)]

Example 7.4.10 MRB – Retrospective adoption

Life Insurer writes an insurance contract with a GMDB rider. Before adoption of ASU 2018-12, the GMDB rider was measured using the insurance benefit model. At the end of Policy Year 4, Life Insurer recorded a $51,121 liability for the GMDB rider using the insurance benefit model.

Life Insurer adopts ASU 2018-12 at the beginning of Policy Year 5 (the transition date). Upon adoption, the GMDB rider meets the definition of an MRB and is measured at fair value using the required retrospective transition method. Life Insurer maximizes relevant observable information to determine the attributed fee to be used to calculate the fair value of the MRB at contract issuance. Total attributed fees do not exceed total contract fees and assessments collectible from the contract holder.

For illustrative purposes, this example assumes no expense fees or maintenance fees. In addition, the numbers in this example are rounded.

Life Insurer uses the following discount rates to measure the GMDB rider under ASU 2018-12.

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	Discount rate[1]	Risk-free rate	Own credit spread
At contract issuance	3.00%	2.50%	0.50%
At transition	3.75%	3.00%	0.75%

Note:
1. The sum of the risk-free rate and own credit spread.

At transition, Life Insurer estimates its 'at contract issuance' future cash flow assumptions for all policy years reflecting management's best estimates of projected rider charges and projected excess claims as follows.

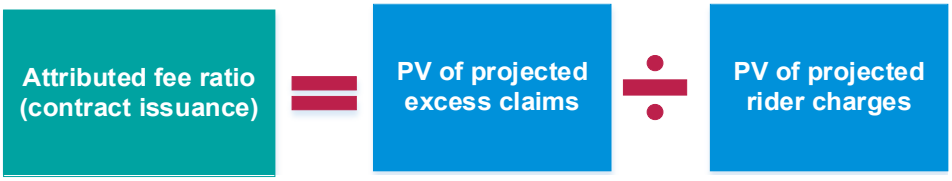
Projected rider charges and excess claims		
Policy year	**Rider charges (a)**	**Excess claims (b)**
1	62,000	20,000
2	62,000	28,000
3	62,000	36,000
4	62,000	44,000
5	62,000	52,000
6	62,000	60,000
7	62,000	68,000
8	62,000	76,000
9	62,000	84,000
10	62,000	92,000

Attributed fee ratio calculation

Life Insurer calculates the 'at contract issuance' present value of the projected rider charges and projected excess claims using the contract issuance discount rate (3.00%) as follows.

Cash flows	At contract issuance discount rate (3.00%)
Projected rider charges (sum of entries in column (a) for all policy years)	528,873
Projected excess claims (sum of entries in column (b) for all policy years)	461,074

Life Insurer uses the calculated present value of projected cash flows to calculate the attributed fee ratio at contract issuance of 87.2% ($461,074 ÷ $528,873) as follows.



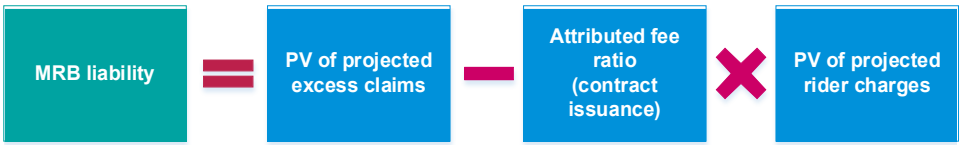
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MRB liability (asset) calculation at transition date

Life Insurer calculates the present value of projected rider charges and the present value of projected excess claims for Policy Years 5 to 10 discounted using the transition discount rate. For illustrative purposes, this example assumes no changes in future projections from the assumptions used at original contract issuance.

Cash flows	At transition discount rate (3.75%)
Projected rider charges (sum of entries in column a for Policy Years 5 to 10)	327,674
Projected excess claims (sum of entries in column b for Policy Years 5 to 10)	375,989

Life Insurer uses the calculated present value of projected cash flows (at transition discount rate) to calculate the MRB liability at transition of $90,257 [$375,989 – (87.2% × $327,674)] as follows.



Change in instrument-specific credit risk calculation

Life Insurer calculates the present value of projected rider charges and the present value of projected excess claims for Policy Years 5 to 10 discounted using the risk-free rate at transition + the contract issuance own credit spread (instrument-specific credit risk). Life Insurer uses the current risk-free rate to isolate the portion of the change in fair value that is not due to changes in the risk-free rate.

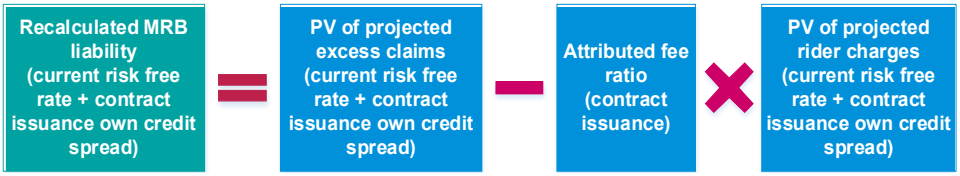
Cash flows	At a discount rate of 3.50%[1]
Projected rider charges (sum of entries in column a for Policy Years 5 to 10)	330,370
Projected excess claims (sum of entries in column b for Policy Years 5 to 10)	379,382

Note:

1. The sum of the current risk-free rate at transition (3.00%) + the contract issuance own credit spread (0.50%).

Life Insurer uses these projected cash flows and the attributed fee ratio (contract issuance) to recalculate the MRB. This recalculated MRB will be used to determine the change in the own credit spread (instrument-specific credit risk) from contract issuance to transition. The recalculated MRB is $91,299 [$379,382 – (87.2% × $330,370)], as follows.

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At transition, the cumulative difference in the MRB because of differences in the instrument-specific credit risk since contract issuance is $1,042 [$90,257 – $91,299].

Calculation of financial statement amounts

At the transition date, Life Insurer records the following journal entry.

	Debit	Credit
Retained earnings[1]	40,178	
Liability for policy benefits (GMDB rider)	51,121	
AOCI		1,042
MRB liability		90,257
To record transition adjustment for MRB liability with change in own credit spread recorded in AOCI.		

Note:
1. $90,257 + $1,042 – $51,121.

Example 3.4.10 illustrates the recalculation of the MRB liability after adoption using this same fact pattern.

7.4.30 Observable information on adoption

An entity should maximize the use of relevant observable information as of contract issuance and minimize the use of unobservable information. If assumptions are unobservable or unavailable and cannot be independently substantiated, an entity may use hindsight to determine these assumptions. [944-40-65-2(f)]

Question 7.4.30 Can internal data meet the requirement for information to be observable as of contract issuance?

Interpretive response: Yes. Internal data can meet the requirement for information that is observable as of contract issuance. An entity should look to all available data, whether internal or external, to determine if it is relevant, observable and able to be independently substantiated. [944-40-65-2(f)]

For example, a contract has a GMWB and a GMDB feature. If under legacy US GAAP an entity calculated the fair value of the GMWB as an embedded derivative, it is likely that some relevant observable data is available to value the

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GMDB. Accordingly, the entity may be less likely to use hindsight for certain assumptions – e.g. own credit risk and lapses.

7.4.40 Use of hindsight

If assumptions are unobservable or unavailable and cannot be independently substantiated, an entity may use hindsight to determine these assumptions. [944-40-65-2(f)]

Question 7.4.40 Is hindsight applied at the individual assumption level?

Interpretive response: Yes. Hindsight is applied at the individual assumption level. An entity must first determine if it has observable data from the issuance of the contract at the individual assumption level that is relevant and able to be independently substantiated. If so, hindsight cannot be used. [944-40-65-2(f)]

If observable data is not available, hindsight is used at the individual assumption level to determine the relevant fair value assumptions at original contract issuance. [944-40-65-2(f)]

Question 7.4.50 Is using hindsight equivalent to using actual historical experience?

Interpretive response: No. Using hindsight is not equivalent to using actual historical experience information. If relevant observable information as of contract issuance is not available to calculate the fair value of an MRB, an entity is permitted to use hindsight to develop its best estimate of the relevant assumptions at contract issuance. [944-40-65-2(f)]

However, determining contract issuance assumptions is inherently different from substituting actual known data after contract issuance into the fair value calculation – e.g. lapse information. An entity may use actual historical experience as a component to determine the contract issuance assumptions used in the fair value calculation, but it should not be the sole consideration. [944-40-65-2(f)]

7.5 Transition disclosures

7.5.10 Overview

Excerpts from ASC 944-40

> Transition Related to Accounting Standards Updates No. 2018-12, *Financial Services–Insurance (Topic 944): Targeted Improvements to the Accounting for*

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Long-Duration Contracts, No. 2019-09, *Financial Services–Insurance (Topic 944): Effective Date*, and No. 2020-11, *Financial Services-Insurance (Topic 944): Effective Date and Early Application*

65-2 The following represents the transition and effective date information related to Accounting Standards Updates No. 2018-12, *Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts,* No. 2019-09*, Financial Services—Insurance (Topic 944): Effective Date,* and No. 2020-11*, Financial Services—Insurance (Topic 944):*

Transition disclosures

g. An insurance entity shall disclose the following information about the liability for future policy benefits and deferred acquisition costs (and balances amortized on a basis consistent with deferred acquisition costs, either as required by this Topic or as a result of an accounting policy election) in the year of adoption:
   1. A disaggregated tabular rollforward of the ending balance of the reporting period before the transition date to the opening balance at the transition date (consistent with the disaggregated tabular rollforward required by paragraphs 944-30-50-2B(a) and 944-40-50-6(a)). If an insurance entity elects to apply the transition guidance on a retrospective basis as described in (e), the insurance entity shall further disaggregate the rollforward between the effects of the retrospective application and the modified retrospective application.
   2. Qualitative and quantitative information about transition adjustments related to:
      i. The opening balance of retained earnings
      ii. Accumulated other comprehensive income
      iii. Net premiums exceeding gross premiums
      iv. The establishment of a premium deficiency as required in Subtopic 944-60.

h. An insurance entity shall disclose the following information about market risk benefits:
   1. A disaggregated tabular rollforward of the ending balance of the reporting period before the transition date to the opening balance at the transition date (consistent with the disaggregated tabular rollforward required by paragraph 944-40-50-7B(a)).
   2. Qualitative and quantitative information about transition adjustments related to the opening balance of retained earnings and accumulated other comprehensive income.

Contracts derecognized before the effective date because of sale or disposal

u. If an insurance entity qualifies for and elects to apply the accounting policy election in (q), the insurance entity shall disclose in the notes to financial statements a qualitative description of each sale or disposal transaction to which it applied the accounting policy election.

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7.5.20 Disclosures before adoption

SEC Staff Accounting Bulletin Topic 11.M (SAB Topic 11.M or SAB 74) requires SEC registrants to evaluate new ASUs that they have not yet adopted when determining what financial statement disclosures to make about the potential material effects of adopting those ASUs.

Question 7.5.10 What is an SEC registrant required to disclose related to the potential effects of ASU 2018-12 before adoption?

Interpretive response: An SEC registrant is required to disclose the potential effects that recently issued accounting standards may have on the financial statements when the standards are adopted. [250-10-S99-5]

The objectives of the disclosure are to: [250-10-S99-5]

- notify financial statement users that a standard has been issued that the registrant will be required to adopt in the future; and
- assist those users in assessing the significance of the effect that the standard will have on the registrant's financial statements when adopted.

Therefore, for reporting periods before ASU 2018-12 is adopted, a registrant is required to disclose the potential effects of ASU 2018-12 on its financial statements. These disclosures should include the following: [250-10-S99-6]

- a brief description of the standard;
- the date that adoption is required and the date that the registrant plans to adopt, if earlier;
- a discussion of the method of adoption;
- a discussion of the effect that adoption of the standard is expected to have on the financial statements, unless not known or reasonably estimable. In that case, a statement to that effect may be made; and
- the potential effect of other significant matters that the registrant believes may result from the adoption of the standard is encouraged – e.g. technical violations of debt covenant agreements, planned or intended changes in business practices.

If a registrant is not able to reasonably estimate the effect ASU 2018-12 will have on its financial statements, it should consider additional qualitative disclosures to assist financial statement users in determining the significance of ASU 2018-12's effect on its financial statements when adopted. The SEC staff expects these qualitative disclosures to include: [250-10-S99-6]

- a description of the effect of the accounting policies that the registrant expects to apply, if determined, and a comparison with the current accounting policies; and
- the registrant's progress in implementing the new standard and the significant implementation matters that it still needs to address.

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The purpose of these disclosures is to ensure that financial statement users understand the significance of the effect that ASU 2018-12 is expected to have on the registrant's financial statements, as well as a clear timeline for the expected implementation of the standard. [250-10-S99-6]

The SEC staff expects SAB 74 disclosures for new standards to become more detailed as the effective date approaches. Therefore, even if a registrant provides only qualitative disclosures because it is not able to reasonably estimate the effect of ASU 2018-12, it should augment its disclosures at each reporting date for any further relevant information. Additionally, it should continue to modify any quantitative disclosures as its estimates change and it receives more information.

The SEC staff's views on how disclosures should evolve as the effective date approaches were included in two speeches before the 2016 AICPA National Conference on Current SEC and PCAOB Developments. Although these speeches mention the revenue recognition standard (issued through ASU 2014-09), they provide important insights into the SEC staff's expectations regarding ASU 2018-12 and other significant new accounting standards that have long periods between issuance and adoption.

Excerpt from SEC speech

Comments of Wesley R. Bricker, SEC Deputy Chief Accountant, at the 2016 AICPA National Conference on Current SEC and PCAOB Developments

The changes in standards will impact all companies, and even if the extent of change for a particular industry or company is slight, the disclosures necessary to explain the changes – and when implemented, to describe revenue streams – may not be. Investors and OCA staff will be looking for increased disclosures in 2016 filings and during 2017 about the significance of the impact – whether quantitative or qualitative – of revenue recognition, among the other new standards, when those standards are adopted in the future. In addition, companies may find it helpful to investors to incorporate a discussion of the anticipated effects of the standard into their investor outreach activities to foster timely absorption of the information by market participants.

Timely implementation of the new standard is important … Particularly for companies where implementation is lagging, preparers, their audit committees and auditors should discuss the reasons why and provide informative disclosures to investors about the status so that investors can assess the implications of the information. Successful implementation requires companies to allocate sufficient resources and develop or engage appropriate financial reporting competencies.

Excerpt from SEC speech

Comments of Sylvia E. Alicea, Professional Accounting Fellow, at the 2016 AICPA National Conference on Current SEC and PCAOB Developments

I'd like to offer a few additional points before moving on to my final topic. First, I believe a registrant should not be reluctant to disclose reasonably estimable

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quantitative information merely because the ultimate impact of adoption may differ, since that information may be relevant to investors even while lacking complete certainty. Second, I would encourage a registrant to disclose known or reasonably estimable quantitative information even if it's only for a subset of the registrant's arrangements – for example, one product category or revenue stream (accompanied by the appropriate disclosure, of course) – rather than waiting until all of the impacts are known. Third, these disclosures should be consistent with other information provided to the Audit Committee and investors, and they should be subject to effective internal control over financial reporting. As management completes portions of its implementation plan and develops an assessment of the anticipated impact, effective internal control should be designed and implemented to timely identify disclosure content and ensure that appropriately informative disclosure is made.

Question 7.5.15 Should SAB 74 (SAB Topic 11.M) disclosures be included in the notes to the financial statements?

Interpretive response: It depends. SAB 74 (SAB Topic 11.M) indicates that disclosure in the financial statements should be considered when recently issued accounting standards constitute a 'material matter'. If a recently issued accounting standard does not constitute a material matter, we believe the entity is not required to include the disclosures in the notes to the financial statements (although disclosure in MD&A may still be appropriate).

SAB 74 does not further define 'material matter'. An entity's determination of whether the adoption of ASU 2018-12 constitutes a material matter based on the guidance in SAB 74 is a judgment, for which the entity's analysis should be documented.

In making its determination, we believe an entity should consider both qualitative and quantitative factors. We believe these factors should include, but are not limited to, the following.

- The number and nature of inquiries from analysts and other investors about the impact of adopting ASU 2018-12.
- Whether adoption will affect compliance with debt covenants or other contractual requirements.
- The transition method. ASU 2018-12 is adopted using a retrospective transition method for MRBs. A modified retrospective transition method is used for other balances, unless the criteria to apply retrospectively are met and the retrospective method is elected (see sections 7.3 and 7.4).
- The amount of cumulative effect of adoption in relation to various financial statement amounts as well as other metrics.

We expect that an entity will also consider other determinations of whether recently adopted and pending accounting standards constitute material matters.

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This is to evaluate whether its approach applied, and judgments used, in those cases is consistent with its determination in adopting ASU 2018-12.

In the past, some entities may have included SAB 74 disclosures in the notes to the financial statements without evaluating whether adoption of those accounting standards constituted material matters. In those circumstances, we do not believe an entity is required to continue including all future SAB 74 disclosures in the notes. Instead, we believe that entities may determine whether SAB 74 disclosure in the notes is appropriate based on their determination of whether adoption of each pending accounting standard (including ASU 2018-12) constitutes a material matter.

There may be circumstances in which an entity that has performed an analysis that considers relevant quantitative and qualitative factors will conclude that adoption of ASU 2018-12 is not a material matter – even when the cumulative effect of adoption is expected to exceed quantitative materiality for the financial statements as a whole in the year preceding adoption. Conversely, there may be circumstances in which an entity will conclude that adoption of ASU 2018-12 is material matter when the cumulative effect adjustment is expected to be less than quantitative materiality for the financial statements as a whole in the year preceding adoption.

7.5.30 Adoption disclosures

An entity is required to make certain transition disclosures in the period ASU 2018-12 is adopted.

Liability for future policy benefits and DAC[1]	Market risk benefits	Exclusions
A disaggregated tabular rollforward of the ending balance of the reporting period before the transition date to the opening balance at the transition date. [944-40-65-2(g)(1)]	A disaggregated tabular rollforward of the ending balance of the reporting period before the transition date to the opening balance at the transition date. [944-40-65-2(h)(1)]	A qualitative description of each sale or disposal transaction to which the entity applied the accounting policy election [944-40-65-2(u)]
If retrospective adoption is elected, the rollforward should be further disaggregated between the effects of the retrospective adoption and the modified retrospective adoption. [944-40-65-2(g)(1)]	Qualitative and quantitative information about transition adjustments related to the opening balance of retained earnings and AOCI. [944-40-65-2(h)(2)]	
Qualitative and quantitative information about transition adjustments related to: [944-40-65-2(g)(2)] • the opening balance of retained earnings;		

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Liability for future policy benefits and DAC[1]	Market risk benefits	Exclusions
• AOCI; • net premiums exceeding gross premiums; and • the establishment of a premium deficiency as required in Subtopic 944-60.		

Note:

1. Includes balances amortized on a basis consistent with DAC – either as required by Topic 944 or as a result of an accounting policy election.

Question 7.5.20 Can transition disclosures be aggregated at a level different from the post-adoption disclosures required?

Interpretive response: No. The level of disaggregation must be consistent with the disaggregated rollforwards required for annual and interim reporting periods. For further discussion about required disclosure (see section 6.5). [944-40-65-2(g)(1), 65-2(h)(1)]

Question 7.5.30 Can the transition guidance be applied to changes in accounting principles outside the scope of ASU 2018-12?

Interpretive response: No. For changes in accounting principle outside the scope of ASU 2018-12, the entity should comply with Topic 250 (accounting changes), including related disclosure requirements. Those changes:

- are discrete and separate from the adoption of ASU 2018-12;
- should not follow the transition guidance in ASU 2018-12; and
- should meet the allowability and preferability criteria of Topic 250.

For further guidance, see section 3.3 of KPMG Handbook, Accounting changes and error corrections.

Question 7.5.40 Are transition disclosures required in interim periods during the year of adoption?

Interpretive response: Yes. The transition disclosures for the liability for future policy benefits, DAC and MRBs are required to be presented in the year of adoption. As such, we believe that if an entity publishes interim financial statements, the transition disclosures are presented within each interim period's financial statements during the year of adoption. However, those

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disclosures would not be required in interim periods after the year of adoption. [944-40-65-2(g), 944-40-65-2(h)]

For further guidance, see KPMG Handbook, Accounting changes and error corrections.

Question 7.5.50 Are SEC registrants required to provide all annual disclosures for each interim period in the year of adoption?

Interpretive response: Yes. Article 10 of Regulation S-X requires SEC registrants to provide both the annual and interim disclosures in each quarterly report in the year of adoption of a new accounting standard – i.e. the first, second and third quarter Form 10-Q filings. [Reg S-X, Article 10, FRM 1500)]

Specifically, Article 10 requires disclosures about material matters that were not disclosed in the most recent annual financial statements. Therefore, when a registrant adopts a new accounting standard in an interim period (which includes the initial interim period of a fiscal year – e.g. as of the beginning of the first quarter of the fiscal year), it is expected to provide both the annual and the interim period financial statement disclosures prescribed by the new accounting standard, to the extent they are not duplicative with other disclosures. [Reg S-X Article 10, FRM 1500)]

For further guidance, see KPMG Handbook, Accounting changes and error corrections.

Excerpt from ASC 250-10

> Accounting Changes

• > Change in Accounting Principle

• • > Justification for a Change in Accounting Principle

45-11 In the preparation of financial statements, once an accounting principle is adopted, it shall be used consistently in accounting for similar events and transactions.

45-12 An entity may change an accounting principle only if it justifies the use of an allowable alternative accounting principle on the basis that it is preferable. However, a method of accounting that was previously adopted for a type of transaction or event that is being terminated or that was a single, nonrecurring event in the past shall not be changed. For example, the method of accounting shall not be changed for a tax or tax credit that is being discontinued. Additionally, the method of transition elected at the time of adoption of a Codification update shall not be subsequently changed. However, a change in the estimated period to be benefited by an asset, if justified by the facts, shall be recognized as a **change in accounting estimate**.

45-13 The issuance of a Codification update that requires use of a new accounting principle, interprets an existing principle, expresses a preference for

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an accounting principle, or rejects a specific principle may require an entity to change an accounting principle. The issuance of such an update constitutes sufficient support for making such a change.

> Accounting Changes

• > Change in Accounting Principle

50-1 An entity shall disclose all of the following in the fiscal period in which a **change in accounting principle** is made:

a. The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable.
b. The method of applying the change, including all of the following:
    1. A description of the prior-period information that has been retrospectively adjusted, if any.
    2. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of changes in the applicable net assets or performance indicator) is not required.
    3. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.
    4. If **retrospective application** to all prior periods is impracticable, disclosure of the reasons therefore, and a description of the alternative method used to report the change (see paragraphs 250-10-45-5 through 45-7).
c. If **indirect effects of a change in accounting principle** are recognized both of the following shall be disclosed:
    1. A description of the indirect effects of a change in accounting principle, including the amounts that have been recognized in the current period, and the related per-share amounts, if applicable
    2. Unless impracticable, the amount of the total recognized indirect effects of the **accounting change** and the related per-share amounts, if applicable, that are attributable to each prior period presented. Compliance with this disclosure requirement is practicable unless an entity cannot comply with it after making every reasonable effort to do so.

Financial statements of subsequent periods need not repeat the disclosures required by this paragraph. If a change in accounting principle has no material effect in the period of change but is reasonably certain to have a material effect in later periods, the disclosures required by (a) shall be provided whenever the financial statements of the period of change are presented.

Pending Content

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

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50-1 An entity shall disclose all of the following in the fiscal period (which may be an interim or annual reporting period) in which …

50-2 An entity that issues interim financial statements shall provide the required disclosures in the financial statements of both the interim period of the change and the annual period of the change.

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Index of changes

This index lists the significant additions and changes made in this edition to assist you in locating recently added or updated content. The following symbols are used throughout this Handbook to indicate the types of revisions made in this edition for sections, Questions, Examples and other items:

** new item
# significant updates or revisions to the item

2. Liability for future policy benefits

Questions

Question 2.3.190 What happens when the net premium ratio is greater than 100%?#

Question 2.5.36 Are unrealized gains and losses included in the PVFP balance used for premium deficiency testing?**

Question 2.7.10 Can an entity combine the remeasurement gain (loss) with other items?#

Examples

Example 2.2.20 Remeasurement of liability for future policy benefits – no capping of the net premium ratio#

Example 2.2.30 Remeasurement of liability for future policy benefits – net premium ratio capped at 100%**

Example 2.2.40 Remeasurement of liability for future policy benefits – net premium ratio reduced below 100%**

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- Consolidation
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- Credit impairment
- Crypto assets
- Debt and equity financing
- Derivatives and hedging
- Discontinued operations and held-for-sale disposal groups
- Earnings per share
- Employee benefits
- Equity method of accounting
- Fair value measurement
- Financial statement presentation
- Foreign currency
- GHG emissions reporting
- Going concern
- IFRS® compared to US GAAP
- Impairment of nonfinancial assets
- Income taxes
- Internal control over financial reporting
- Inventory
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- Long-duration contracts
- Non-GAAP financial measures
- Research and development
- Revenue recognition
- Revenue: Real estate
- Revenue: Software and SaaS
- SEC pro forma financial information
- Segment reporting
- Service concession arrangements
- Share-based payment
- Software and website costs
- Statement of cash flows
- Tax credits
- Transfers and servicing of financial assets

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